TESTIMONY
By
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VICE CHAIRMAN
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To
HOUSE OF REPRESENTATIVES
AGRICULTURE SUBCOMMITTEE ON
GENERAL FARM COMMODITIES AND RISK MANAGEMENT

Washington, D.C.
May 4, 2005

Good morning Mr. Chairman and Members of the Agriculture Subcommittee on General Farm Commodities and Risk Management. My name is Greg Burger, and I am president of Farmers Crop Insurance Alliance, located in Eau Claire, Wisconsin. We are owned by Farmer Alliance Company of McPherson, Kansas. I appear here today in my capacity as Vice Chairman of the American Association of Crop Insurers (AACI).

On behalf of the Board of Directors and members of AACI, I want to thank you for scheduling this hearing. It comes at a very critical time for the federal crop insurance program. Although the program has grown considerably and enjoys broad based support among farmers, ranchers and growers for providing improved risk protection, there are some misconceptions and challenges that need to be more fully researched and understood. My testimony will address each of these aspects of the modern federal crop insurance program.

The Federal Crop Insurance Program Is a Success

While congressional support for the federal crop insurance program historically has been strong and consistent, the Committee is to be specially commended for development and adoption of the Agricultural Risk Protection Act (ARPA) of 2000. ARPA provisions were designed to encourage farmers to buy higher coverage in decisions regarding risk protection and management. We believe ARPA is proving to be a success story and the Committee should be proud of this effort on behalf of all farmers, ranchers and growers.

USDA's crop insurance program participation data as reported by the Risk Management Agency (RMA) confirms our belief regarding the value and contribution of ARPA to building a quality risk protection and management program for American farmers. For the first time, total premium was reported to have reached the four billion dollar mark in 2004, slightly exceeding $4.1 billion. The average annual total premium for the four years since the passage of ARPA is reported to be more than 50 percent larger than the same statistic for the four preceding years. Net acres insured in 2004 are reported to have exceeded 221 million. Annually, the RMA data indicate that net acres insured have averaged more than 13 percent greater since ARPA than for the four-year period leading up to it.

The Federal Crop Insurance Program is the Envy of the World

It has taken not only years, but decades to have the federal crop insurance program attain the current levels of participation and benefit for American farmers. And, while certainly there is room and opportunity to continue improving the program, today it stands second to none as a world-class agriculture risk protection and management tool. In fact, other countries such as France have begun to research the program and are even starting their own crop insurance program. In this connection, it is noteworthy to recall that a WTO panel apparently ruled that the U.S. crop insurance program did not suppress prices. This revelation becomes yet another reason the Committee should be proud and protective of the federal crop insurance program that they have created.

A lot of people have contributed to the development and evolution of the modern crop insurance program, however, no effort has been greater than that made by Congress and members of this Committee. On behalf of the AACI membership and the farmers, ranchers and growers we serve, I want to take this opportunity to thank you for your support of a quality risk protection and management program. Given the natural and global market elements they work and live with every day that are beyond their control, America's farmers, ranchers and growers deserve the certainty and predictability of the risk management program you have provided.

All Federal Crop Insurance Program Gains Are Now At Risk

In spite of all the progress we have made over the last few years and despite the tremendous boost the program was given when you enacted APPA in 2000, the crop insurance program is now at great risk. A number of initiatives taken by RMA could destroy in a few years all the gains made over the last 25 years.

RMA's initiatives fall into these categories:

1. RMA is on a mission to push through a premium reduction program that will discriminate against small farmers and create chaos in the marketplace.
2. Additional paperwork and regulatory burdens put on the private sector by the 2005 SRA and other USDA regulations are making the crop insurance program more difficult and costly for the private sector to deliver.

The RMA's Efforts to Force a Premium Reduction Program Upon the Crop Insurance Industry are Inherently Discriminatory Against Small Farmers

Since December 2002, RMA has been on a mission to force premium discounting on the Crop Insurance Delivery System. They have used an outdated section of the crop insurance law enacted in 1994 when reimbursement for delivering crop insurance was almost 32% of premium, to impose premium discounting on an industry that is now reimbursed at a rate of only 21%. They have taken this section of the law, Section 508(e)(3) of the Federal Crop Insurance Act and read it in a vacuum, ignoring all other provisions of law. They have made no attempt to insure that the premium discounting company is not discriminating against small farmers. They are ignoring their own regulations, which require that a company that offers insurance in a State must offer it to all eligible farmers in a State. They are ignoring the Standard Reinsurance Agreement, which requires that companies do extensive training of loss adjusters.

RMA is misrepresenting the plain meaning of the law by saying that the law requires that they implement a PRP rule this year. The law does not require any such thing. If they cannot devise a rule that does not discriminate against small farmers and a rule that meets all of their other rules, limitation and procedures, they should not issue a final rule.

We have heard that in briefings of Congressional Staff, RMA has represented that they must finalize the rule because the companies are clamoring for it. Nothing could be further from the truth. Several companies did apply for a PRP program last year in order to meet the unfair competition of the one company that was approved for discounting. However, this was done only as a defensive strategy. All of the established companies that deliver the program are strongly opposed to the PRP. Only the one small start-up company that is now allowed to offer premium discounts favors the rule. I believe the comments filed on the proposed PRP rule will bear this out.

In the comments filed by AACI's counsel, which are attached as Appendix A), the following major points were made.

1. **When the proposed rule is considered in the context of RMA's record, it is blatant discrimination.**
2. **RMA ignored the history and purpose of the crop insurance program in approving and operating the current premium discount program.**
3. **The approval of a premium discounter's application in 2002 was a violation of established law and regulations.**
4. **RMA never took any action when the original basis of its premium discount approval proved to be false and is compounding this negligence in going forward with the proposed rule.**
5. **RMA has consistently refused to acknowledge the fact that their PRP program will force crop insurance agencies that serve small farmers out of business unless they discriminate.**
6. **The proposed rule's impact is inherently discriminatory and could subject USDA and the industry to massive class action lawsuits.**

7. **The rulemaking process has generated many comments, and we are very concerned that RMA does not have time to develop program procedures and oversight of the PRP program for the 2006 crop season.**

We wish to emphasize this last point. Public statements by RMA management indicate that they are making a sham of the rulemaking process. In a meeting with the industry on April 19, RMA Associate Administrator, David Hatch, stated that the agency would implement a rule allowing premium discounting by July 1, 2005. Therefore, we appeal to Congress to direct RMA to halt the sham process until there can be a thorough investigation of the discriminatory conduct of the current premium discounting program. In our comments on the sham nature of RMA's conduct, we made the following points:

1. **RMA approved the original premium-discounting program with no protections against discrimination and without adequate disclosure to the Board.**
2. **RMA has repeatedly ignored industry complaints about the discriminatory and predatory nature of the current premium discount program.**
3. **RMA sought to go forward with a national premium-discounting program in 2004 and suspended its efforts only when forced by the FCIC Board to conduct a notice and comment rulemaking process.**
4. **RMA has already made a decision that it will go forward with its PRP program regardless of the comments received in the rulemaking process, thereby rendering the process a sham.**
5. **RMA is ignoring the views of the entire crop insurance industry that has served the nation's farmers for many years in favor of the one premium discounting company, and comments of agents and customers of this one company.**
6. **RMA does not have the resources to prevent predatory and discriminatory practices under a PRP program. Thus it would create chaos in the marketplace.**

In our efforts to demonstrate why a premium-discounting program will force crop insurance agencies to discriminate against small farmers or go out of business, we have tried to get RMA to focus on the actual books of crop insurance agencies. They have refused to do so.

Therefore, we have attached as Appendix B data from the Sherry Wegner Agency in Glasscock, Texas. It shows that the agency's average cost of serving a federal crop insurance policy is approximately $300. It is undisputed in the industry that it is just as expensive to service a small policy as a large one. The Wegner Agency has provided a printout of the actual policies sold by the Agency, with the names of policyholders deleted for privacy reasons. If you will focus on the next to last column on the page, you will find the actual commission paid to the Agency. This data demonstrates that many of the commissions paid are substantially below $300. In fact, 58% of them are less than

$300. The Wegner Agency remains profitable because it has some larger policies. Clearly, if a premium discounter is allowed to cherry pick the larger and more profitable policies of the Wegner Agency, the Agency will no longer be able to sever small farmers. It would go out of business.

It is this business reality that we have never been able to get RMA to address. We appeal to Congress to help RMA understand it.

RMA's response to our concerns about discrimination may be that the proposed rule does have some language that prohibits discrimination. However, we believe that RMA has already demonstrated its unwillingness to enforce this new language by its record of allowing discrimination under the current premium-discounting program. Moreover, as several comments on the proposed rule have pointed out, RMA does not have the extensive resources that would be required to enforce such a rule.

Just as important, no rule can trump the laws of economics. No rule can address the simple statement of reality demonstrated by the data provided by the Wegner Agency. A premium-discounting program will make crop insurance unavailable to thousands of the nation's small farmers.

Soybean Rust is a Concern

As a new crop peril, soybean rust is cause for considerable concern across the crop insurance industry. And the industry is, in fact, very concerned about soybean rust, especially given what is known about its destructive potential.

For crop insurance companies, the primary task is one of reducing the level of confusion, especially among its farmer customers and agents. Many situations can create confusion in the crop insurance industry, but the questions and issues accompanying soybean rust thus far are serving to magnify the level that could usually be expected.

With any peril, but especially in the case of a new peril like soybean rust, the primary objective of insurance companies is to develop an accurate understanding among its customers regarding coverage or protection provided by each policy option. Additionally, policyholders need to know the requirements for policies to remain in full force to avoid any potential misunderstandings in the unfortunate event where a loss triggers the filing of a claim. Toward this objective, companies are conducting a variety of educational opportunities, including agent training sessions, customer meetings and customer direct mail communication to help assure farmers have a full and complete understanding of the approved and required practices concerning soybean rust management.

I want to assure the Committee that insurance companies are doing everything we know to do to eliminate confusion on the part of farmers and agents regarding the interface of soybean rust and crop insurance.

Fraud Identification and Control is Improving

No one in the crop insurance industry condones fraud. This committee supported legislation that has assigned greater attention and resources to researching and ending fraud. RMA and the administration have acted aggressively with emphasis on data mining and other means to identify and punish instances of fraud. While, in all likelihood, all fraud has not been stamped out, although that certainly does not make the federal crop insurance program unique in that respect, the general environment is greatly improved and continues to get better. That is our opinion and we thought it should be stated publicly.

Images, especially bad images, seem to be easily perpetuated. Paraphrasing a modern slogan, this crop insurance program is not your old crop insurance program. Things have changed. Oversight has improved. Research and technology is better. The incident of fraud is much less. We encourage the RMA and administration to highlight and promote these changes in an effort to create the proper image of the modern federal crop insurance program. All parties with an interest in the value and utility of the program will benefit from the result, especially the farmer who desperately needs the program to be the best it can be.

Our concern at the membership of AACI is that RMA has instituted so many rules and regulations because of the fraudulent acts of a few that the honest producer is overwhelmed with procedures and vulnerable to severe penalties.

Additional Paperwork and Regulatory Burdens Are Making the Program More Difficult and Expensive to Deliver

<u>Problem definition:</u> To implement the Federal Crop Insurance Act – which includes provisions intending to help control, reduce and eliminate fraud, waste, and abuse in and of the crop insurance program – RMA, working with the authority granted by the FCIC, has developed and finalized certain critical changes to the Basic Provisions for the 2005 crop insurance year. In addition, RMA made other regulatory changes in the new Standard Reinsurance Agreement (SRA) that was adopted in 2004.

While no one condones fraud, waste, and abuse, some of the regulations adopted by RMA are excessively rigid and can result in punitive damages. **For example, some of the changes do not adequately allow for or accommodate common, unintended mistakes and errors of data entry by either farmers or agents and companies, even when there is no adverse pattern of practice.** Nonetheless, under the new provisions, these everyday innocent clerical mistakes would result in substantial penalties at claim filing. The implementation and administration of these regulations, especially after the changes made in 2004, are reaching the point of being overly burdensome and wasteful. Industry resources, both human and capital, are already stressed as a result of the increasing complexity of the insurance program of crop and livestock enterprise risk management. Additionally, the changes establish a discriminatory relationship between USDA agencies regarding the treatment of farmers. For example, reporting errors in the

Farm Service Agency (FSA) records, when discovered, are simply corrected. However, reporting errors in RMA records are not correctable in some instances and penalties can be assessed. This development is occurring in spite of the fact that ARPA called for greater cooperation and reporting and record consistency between the two agencies.

These paperwork and regulatory burdens are too extensive to discuss here, so I have attached them as Appendix C.

RMA Made Unwarranted Cuts in Compensation in the 2005 SRA Based on a Misuse and Suppression of Data

At the time that RMA released its proposed new SRA, we were told that it was based in part on a study done by Milliman USA under a RMA contract.

On March 3, 2005, RMA Administrator, Ross Davidson, appearing before the House Agriculture Appropriations Subcommittee said the Milliman work concluded the industry received an "average rate of return of 15.8 percent over the years 1989-1002 when the average reasonable rate of return was only 14.0 percent."

Both the private industry and Congress have tried unsuccessfully to obtain this study. The private sector filed a request under the Freedom of Information Act (FOIA) on April 27, 2004. Members of this Committee, Mr. Peterson and Mr. Pomeroy, requested a copy of the study in a hearing held on July 21, 2004.

A year later, we still do not have the complete study. We received only part of three of the 28 Milliman reports. In the reports we received, there were serious deletions. We had stipulated that private confidential business information should be redacted. However, we do not believe wholesale deletions of entire sections of 140 pages are appropriate. We have appealed RMA's actions, but our efforts have been stonewalled.

We ask that this Committee join us in demanding that RMA cease the suppression of this information for which it paid over a million dollars in taxpayer money.

Upon reading the partial report that RMA finally released to us, it becomes abundantly clear the authors repeatedly qualified one particular statement referenced at the March 3, 2005 hearing by the RMA Administrator. The following quotes from the November 11, 2002 Milliman USA report to RMA on Historic Rate of Return Analysis are noteworthy as well as instructive:

> "Thus, while MPCI insurers have earned a return somewhat in excess of the cost of capital, the returns are somewhat volatile as evidenced by the fact that in the single catastrophe year, the overall rate of return was -15.6% (negative 15.6%). In fact, we would caution against drawing any strong conclusions on the adequacy or excessiveness of the historical returns based on a sample of thirteen years of data, in light of the fact that only one of those years is a catastrophe year. Had

there been a second catastrophe year in the sample similar in magnitude to 1993, the average return over the period would have been below 14%." [Pages 4-5]

"We caution that actual returns could deviate significantly from the expected returns because of unexpected events. Therefore, a better measurement of whether providers have been reasonably compensated is by comparing mean values over the sample period, and by observing the pattern of difference between actual and reasonable rate of return. … As can be seen in the table (Table 13, Page 37), the actual rate of return is 1.8% larger than the reasonable rate of return for all years, however, the standard deviation of the difference is 10.2%. **Given the magnitude of the standard deviation, the difference does not appear to be statistically significant. (Emphasis added)** In addition, as noted earlier, this result is quite sensitive to the occurrence of catastrophe years in the sample period. **For example, if there had been a second catastrophe year equivalent to 1993 in this sample period, the historical return would have been below 13.7%." (Emphasis added)** [Pages 37-38]

"As with most lines of insurance that have a significant catastrophe exposure, insurers expect to earn significant profits in non-catastrophe years and significant losses in years with catastrophes. As a result, average returns over relatively short sample periods are not necessarily indicative of the long-term pattern of returns. Given the experience in multi peril crop insurance over the past 13 years, we would suggest that the historical returns reported herein would tend to overstate long term returns if the frequency of catastrophes is greater than one in thirteen years, and understate such returns if the frequency is lower than one in thirteen." [Page 38]

In fact, the years selected for the study, 1989-2001, were carefully picked. If the years 1988 and 2002 had been included, the result would have been vastly different. For 1988, a major drought year, the loss ratio was 2.41, the largest in the history of the program. And 2002 was a major loss year with a loss ratio of 1.39. Thus, RMA skewed the result of their study by picking a period in which crop insurance has a loss in only 1 of 13 years (1989-2001), rather than a more representative period of 1988-2002, when crop insurance experienced a loss in three of fifteen years.

Another subject that is important in any profit analysis is the expense side of the equation. The November 11, 2002 Milliman USA report addressed this subject also. Below are several important expense related statements from that report.

"…the FCIC (Federal Crop Insurance Corporation) compensates insurers for the cost of selling and servicing the coverage through the payment of an administrative and operating (A&O) subsidy. This A&O subsidy is intended to cover all costs associated with the sale and servicing of crop insurance policies, excluding, of course, losses. This raises at least two important issues as regards profitability analysis. First, depending on the level of the A&O subsidy relative to actual incurred expenses, there may be a profit or a loss to insurance providers attributable to the subsidy itself. Second, when evaluating crop insurance expense ratios relative to expenses for other lines of insurance, it is imperative to adjust the ratios to put them on a comparable basis." [Page 10]

> "First, and perhaps most important, the GAO concluded that an expense reimbursement equal to 24% of premium would be reasonable in light of their audit of actual company expenses. Currently, the SRA (Standard Reinsurance Agreement) provides for an A&O subsidy ranging from 21% to 24.5% of premium, depending on the fund and plan of insurance. As a consequence, assuming expenses as a percent of premium have remained constant over time, the current A&O subsidy would not be viewed as excessive, regardless of the historical levels of the subsidy." [Page 12]

> "Second, we found several of the GAO conclusions and recommendations inconsistent with the objective of delivering multi peril crop insurance through the private sector. For example, expenses related to acquiring a competitor's book of business, or paying incentive compensation to employees, are parts of the cost of doing business in the private sector. If crop insurance is to be delivered though this mechanism, then insurers will have to compete for resources to support crop insurance on the same terms as would any other business activity." [Page 12]

> "Finally, the GAO statement that the expense reimbursement could be reduced in the future because crop prices and premiums will increase must be considered in light of several facts. First, a substantial share of insurer expenses is directly dependent on premium. Agents' commissions, which represent a significant portion of expenses (more than half according to the GAO report), are usually a fixed percentage of premiums. As to other expenses, a substantial portion of these are related to employment costs, which tend to increase faster than the general level of prices. Finally, premium increases may reflect expected loss increases, which in turn might result in higher loss adjustment expenses. This is especially true for the introduction of new types of coverage such as revenue assurance. Thus, it is unclear whether increases in the average premium per policy would be sufficient to offset the cost increases associated with higher expenses for labor costs." [Pages 12-13]

> "In contrast to the GAO report's suggestion that the A&O subsidy has exceeded actual expenses, there are data from insurer annual statements that indicate the opposite – that is, that the expense reimbursement has fallen short of actual expenses. These data are available for MPCI for all years from 1992 to the present, from the statutory financial reports insurers file with regulators." [Page 13]

We believe research of this nature is very important and can be useful in developing improved insights and understandings of the crop insurance industry. However, taking information out of context and attempting to have interrelated findings stand-alone helps create and perpetuate misconceptions—in this instance about the rate of return in the crop insurance industry. Other than the pages redacted by USDA, the referenced Milliman USA report is attached as Appendix D.

Justice Department Ruling

The final source of industry concern and stress that I will present today relates to the process followed by the government in developing the most recent Standard Reinsurance Agreement (SRA). Previous SRAs had been developed using what everyone knew to include real negotiation activities and efforts. Unfortunately, for the last SRA, which was completed in July 2004, RMA apparently requested and the Department of Justice (DOJ) provided a ruling that disallowed the continuation of real negotiation activities and efforts. Absent true negotiations, companies were left without any traditional means of participating in the SRA development process. As a result, companies were forced for the first time to seek congressional involvement in the SRA development process. While the industry definitely appreciates any and all opportunities to work with Congress, the approach did not provide true negotiating opportunities. In general, the lingering impression by the industry is that something important may have been lost—a true partnership. If that is the case, there is ample reason for the continuing concern about the ruling.

Administration Budget Proposal

The President's FY06 budget regurgitates a series of crop insurance proposals and policies that have either been tried in the past and found wanting or have been proposed in the past and have been rejected. Two wrongs do not make a right. The President's budget would take the crop insurance program in the wrong direction. For example:

- The President would require farmers who receive farm program payments to purchase crop insurance – otherwise know as mandatory linkage. The proposal actually COSTS some $200 million annually. The general notion behind the proposal is that if farmers are required to purchase crop insurance, demand for ad hoc disaster payments would decrease. The 1994 crop insurance reform act required mandatory linkage. It lasted exactly one year before Congress chose to undo it as some farmers balked at the requirement. Some farmers, given their risk profile, choose to self insure. Moreover, demand for ad hoc disaster payments is generated usually from areas with high crop insurance participation that also suffer from unusually high losses or a series of back-to-back losses – not lack of participation. Participation in the crop insurance program has never been higher than today!

- In order to pay for the cost of mandatory linkage, the President proposes to increase the cost of buying insurance by reducing farmer premium subsidies at all levels of coverage, saving some $175 million annually. This will force farmers to purchase higher deductible insurance policies as the cost of insurance increases. If the goal is to reduce demand for ad hoc disaster payments, then forcing farmers to purchase higher deductible insurance policies makes no sense. The

Agricultural Risk Protection Act of 2000 INCREASED incentives to purchase higher coverage levels. This proposal starts to undo that act.

- Finally, in order to generate budget savings the President's budget proposal would decrease the payments made on behalf of farmers to deliver the crop insurance program. Similar proposals have been made by the President in the past and rejected by Congress. In fact the crop insurance industry negotiated in good faith with the Administration last year to reduce federal costs to deliver the crop insurance program without impacting service to farmers. Some $30 million annually is now being saved because of that negotiation. The President's proposals go well beyond that good faith negotiation, attempting to cut another $140 million or so in delivery expenses. Service to farmers would significantly degrade if these proposals were enacted.

The crop insurance program has been successfully growing over the past 5 years to become the premier risk management tool for American farmers. The President's budget proposals would undo this success. The proposals have been rejected in the past, they should be rejected again!

It is Time for a New Beginning

It is most unfortunate that I had to come before the Committee today and recite what is wrong with the administration of the crop insurance program. Over the 25 years of this program, we have had to overcome serious obstacles and setbacks to achieve the current program. However, during this time RMA management worked cooperatively with the industry to improve the program. Now, we in the private sector feel that we are always trying to fight off new RMA program changes that would seriously undermine the program. Thus, we are going backward rather than forward for the first time in the program's history. If this is allowed to continue, the crop insurance program that farmers rely on will ultimately be destroyed. We ask the Committee's help in restoring forward momentum to the crop insurance program.

Appendix A

April 22, 2005

Mr. Craig Witt
Director, Reinsurance Services Division
Risk Management Agency
U.S. Department of Agriculture
1400 Independence Avenue, SW
Ag Stop 0805
Washington, DC 20250-0801

Subject: Premium Reduction Plan (PRP)

Dear Mr. Witt:

Pursuant to the Federal Register notice and request of February 24, 2005, Vol. 70, No. 36, page 9001, submitted by the Federal Crop Insurance Corporation (FCIC) to amend the General Administrative Regulations (7CFR part 400, subpart V), to include provisions regarding the necessary revisions to the Plan of Operations and administration of the premium reduction plans authorized under Section 508(e)(3) of the Federal Crop Insurance Act (Act), the American Association of Crop Insurers is pleased to provide the following comments and opinions.

When the Proposed Rule is Considered in the Context of RMA's Record, it is Blatant Discrimination

Efforts to finalize the proposed rule and all other efforts to implement Section 508(e) (3) of the Act must be terminated immediately. The rule as published is legally defective and should be withdrawn. It does not protect the crop insurance delivery system from the predatory and discriminatory practices that characterize the current Premium Reduction Program (PRP) operated by one company. It does not protect the right of the nation's small and medium-sized family farmers to obtain crop insurance from an agent who will serve them. The current premium discount program is being operated without standards to protect the integrity of the delivery system and its historic mission to serve all farmers in every geographic region in which a company operates. Although the proposed rule has some standards, they are not adequate to protect the delivery system from a management that has shown no regard for serving small and medium-sized farmers under the current PRP program. It cannot protect the delivery system from a management that is on a mission to rush through a premium discounting program even if it destroys the crop insurance program.

Moreover, The Risk Management Agency's (RMA) insistence on operating the current PRP program in a discriminatory manner that is contrary both to law and regulation disqualifies them from being capable of administering the new program that would be established by the proposed rule. Thus, the provision of the rule that allows the approval of a plan of operations "in the sole determination of the management" should be removed. Any resolution of the FCIC Board that vests in the RMA any authority for policy determinations on PRP should be rescinded and this authority retained by the FCIC Board. Moreover, the FCIC Board should insist on a thorough review and analysis of RMA's administration of the existing PRP program that has been operated for the last two years. An independent contractor should conduct this review before RMA embarks upon a program that will destroy the crop insurance delivery system. The FCIC Board wisely reined in RMA's rush to implement a national PRP program in 2004. It should now restrain RMA management's attempt to make a sham of the rulemaking process mandated by the board.

RMA Ignored the History and Purpose of the Crop Insurance Program In Approving and Operating the Current Premium Discount Program

It is utterly astounding that RMA would so completely ignore both the history of the crop insurance program and its controlling statues and regulations in rushing forward with an ill-conceived premium-discounting program. One thing is abundantly clear to even the most casual observer of the Federal Crop Insurance Program. The program must serve all farmers, of whatever size, in every geographical area in which it is available. There can be no discrimination against farmers based on size or on any other factor. This has been the case since the passage of the Crop Insurance Act of 1980, which established the modern crop insurance program, and in every subsequent act of Congress regarding crop insurance. Congress most recently made this clear in the Agriculture Risk Protection Act of 2000. In Section 165 of that Act, Congress expressed special concern "that all farmers, including minority and limited-resource farmers" participate fully in USDA programs.

In addition, the regulations and the Standard Reinsurance Agreements (SRAs) that have governed the private sector delivery system have always required that Companies that write insurance in a state make the insurance available to all eligible producers. This is true of the current SRA, the 2005 SRA. This SRA provides in Section II(A)(2) that a "company must offer and market all plans of insurance in any state where actuarial documents are available in which it writes a crop insurance contract and must accept and approve applications from all eligible producers". This provision of the SRA makes absolutely clear that cherry picking is not acceptable. It is clear that a company must both market to and accept applications from all eligible producers in a state where it does business.

Moreover, RMA has spent and continues to spend several million dollars each year in educational outreach contracts to educate the small and limited-resource farmers. Before instituting the proposed rule, RMA should spend a small part of that money on an independent contractor who would evaluate its impact on minority, limited-resource, and medium-sized family farms.

The Approval of a Premium Discounter's Application in 2002 was a Violation of Established Law and Regulations

RMA cites as authority for its proposed rule Section 508(e)(3) of P.L. 103-354, the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994, which follows:

> (3) Premium reduction
>
> If an approved insurance provider determines that the provider may provide insurance more efficiently than the expense reimbursement amount established by the Corporation, the approved insurance provider may reduce, subject to the approval of the Corporation the premium charged the insured by an amount corresponding to the efficiency. The approved insurance provider shall apply to the Corporation for authority to reduce the premium before making such a reduction, and the reduction shall be subject to the rules, limitations, and procedures established by the Corporation.

The approval of the premium discounter's application under this Section was irregular, discriminatory, and illegal. This is true because this one section of the law does not exist in a vacuum. All of the general USDA and government-wide laws against discrimination apply to the delivery of crop insurance just as they apply to all other participants in the crop insurance delivery system. All of the extensive requirements of the Standard Reinsurance Agreement, including the requirement that all farmers in the business area be served, and that the Approved Insurance Provider provide extensive training of adjusters still had to be met.

Indeed, RMA should have been well aware of these requirements because a proposed rule was published in 1999 that attempted to thoroughly address these issues. This proposed rule made it abundantly clear in several provisions of the proposed rule that discrimination against small farmers, limited resource farmers, and minority farmers would not be tolerated. The 1999 proposed rule contained five very specific prohibitions against discrimination. See Exhibit A.

Incredibly, RMA, in its rush to approve the premium discounting regulation, chose to ignore this proposed rule entirely. It simply resorted to a hastily drafted resolution that ignored these issues and provided no prohibition against discrimination. This resolution was presented to the FCIC Board, without briefing them on the history and implications of this issue. See Exhibit B

On May 1, 2003, over four months after approval of the PRP application, RMA issued Manager's Bulletin No. MGR-03-008 with the subject "Procedures for Submitting Premium Reduction Plans". It was very vague in terms of protection of small farmers and minority farmers. It only said that the program could not be "unfairly discriminatory". See Exhibit C. The term "unfair discrimination" is defined to mean that if the plan "is based on the loss history of producers or precludes in any manner other producers of an approved crop in an approved State from participating in the program". This Bulletin provides for no obligation that the premium discounter actively market insurance to small producers, limited resource farmers, or minority farmers, in direct contrast to the proposed 1999 rule. It is clear from subsequent conversations that we have had with RMA as well as the way that the premium discounting program is being operated, that RMA's policy is that as long as no farmer is denied a premium discounted policy when he demands it, the requirements of the Bulletin have been met. **Since farmers who are small will not even be offered or made aware of the premium discounted programs, this policy is discriminatory on its face.** This Manager's Bulletin was the operative policy of RMA when it solicited applications from the entire industry in 2004 and it is still the operative policy of RMA. Manager's Bulletin MGR-03-008 should be repealed and disavowed at once.

Moreover, an attached chart (Exhibit D) demonstrates graphically how little concerned the RMA was with the issue of discrimination. It is a comparison of the anti discriminatory features of 1999 rule with manager's bulletin. Given the number of lawsuits filed, and in many cases won, against USDA for discrimination in recent years, this was extremely irresponsible.

In conclusion, current RMA management has taken one obscure and outdated provision of the law out of context and ignored all other controlling provisions of law and regulations in its mission to force a discriminatory PRP policy on the crop insurance program.

RMA Never Took Any Action when the Original Basis of Its Premium Discount Approval Proved to be False and is Compounding this Negligence in Going Forward with the Proposed Rule

The original basis of the approval of the premium discounter's proposal was its representation that it would achieve efficiencies via the sales and service of crop insurance primarily through its online Internet site. This did not work and the discount plan soon changed into a plan of reduced commissions to agents who would concentrate on the largest and most profitable accounts in selected areas. The original basis of the premium discount program was documented in a RMA bulletin issued on January 16, 2003, which is attached as Exhibit E.

In the meeting of the FCIC Board of Directors on December 18, 2002, the premium discount plan was approved, based on nine conditions, including:
"(2) The submitter can demonstrate that it can reduce its costs by a specific amount through an efficiency in the delivery of the federal crop Insurance program;
(3)The efficiency employed by the submitter to reduce its costs does not result in a reduction of service to policyholders;"

There is no evidence whatsoever that RMA has fulfilled its obligation to the Board to insure that these conditions were met. Indeed, as the premium discounter changed its tactics and engaged agents to aggressively solicit only the largest accounts of the traditional crop insurance agents, the agency was confronted with numerous complaints, both by individual agents and organizations of agents about what they considered to be predatory and discriminatory practices. Associate Administrator David Hatch responded to those complaints by saying that he had investigated them and found that they were without merit.

In the face of this experience it is even more incredible that RMA is attempting with this proposed rule to reshape the agency delivery system that has evolved over 25 years in the mold of an experimental premium discount program that is a proven failure. No efficiencies have been demonstrated, other than the "efficiency" of discriminating against small farmers and concentrating on the few largest and most profitable accounts.

Thus, the outcome of the proposed rule would be less competition for a farmer's crop insurance account, not more, for most farmers. More importantly, there is nothing illogical about this outcome, especially from a business standpoint, given the fact that companies are in business to succeed economically, not to enforce public policy objectives. Enforcing public policies is the responsibility of the government, not private companies.

RMA Has Consistently Refused to Acknowledge the Fact That Their PRP Program Will Force Crop Insurance Agencies That Serve Small Farmers Out of Business Unless They Discriminate

Although industry representatives have repeatedly pointed out that crop insurance agencies can no longer afford to serve small farmers (on whose policies they lose money) if premium discounters are allowed to pick off their larger and more profitable accounts, RMA management has refused to acknowledge or comment on this issue. Indeed, they have even refused to examine premium data from agencies that has been offered to prove this point. It is typical for an agency to lose money on the majority of its accounts, while remaining profitable because of the premium on its larger accounts. Thus, RMA has shown a reckless disregard for the current crop insurance delivery system, which has evolved over the 25 years, hostility toward the crop insurance agent force, and a predisposition to discriminate against small farmers.

It is incumbent upon the FCIC Board to require an independent analysis of the impact of the premium discounting program upon the agency force and the small farmers they serve before taking any further action on the proposed rule.

The Proposed Rule's Impact is Inherently Discriminatory and would Subject USDA and the Industry to Massive Class Action Lawsuits

Crop insurance is a public policy of the nation, meaning that it is not merely or strictly a commercial venture. Application of market institutions, including price competition, can yield results that are counter to public policy objectives for the program.

The nature of crop insurance is that it is a federally certified, heavily subsidized and tightly regulated program designed to serve as a significant risk management asset for all U.S. farmers, ranchers and growers. It is sold and serviced by private sector insurance companies through an annual SRA with the RMA of the U.S. Department of Agriculture (USDA), as directed by the FCIC. The law mandates that this publicly supported program be made available to all eligible farmers, rancher and growers without discrimination. This general outcome is the public objective that cannot be assured through the unfettered interaction of normal market forces and institutions.

The current delivery system for crop insurance evolved over the last two and a half decades, as various changes in the program were made. In previous years, crop insurance was only available through government agents and only government adjusters adjusted losses. Since this did not provide adequate and cost-effective service to the nation's farmers, the current private sector delivery system evolved.

The current program provides the right balance of incentives that allows the smallest farmers as well as the largest to be served. However, this system has been put under considerable stress as the expense reimbursement for the delivery of the program has been steadily reduced and the paperwork requirements of the RMA have been steadily increased.

With the proposed rule, which RMA has neither the inclination nor the resources to implement on a fair and impartial basis, RMA is creating a strong set of incentives for a delivery system that will be rife with discrimination and predatory practices. The government will get the kind of delivery system for which it creates the economic incentives. Thus the government is adopting a policy of discrimination that is contrary to the Civil Rights Acts, the Crop Insurance Statutes and various USDA policies and directives. The only predictable result of such a rule will be additional class action lawsuits against the USDA.

As a result of a lawsuit brought by African American farmers who alleged discrimination in USDA credit and benefit programs, USDA was forced to settle with the plaintiffs by paying a sum that has already cost approximately $700 million in payments, debt forgiveness and offsets in the one case, and payments are continuing. See Exhibit F. In addition to this case, Pigford v. Glickman, USDA is facing several similar suits from other classes of farmers, including Native Americans, Hispanic Americans, and women who are farmers. As the USDA continues to face an onslaught of cases on discrimination, the cost to the American taxpayer could be several billion dollars. **It is amazing that RMA would push forward a policy that would create entirely new classes of plaintiffs who would be able to bring suit against USDA for discrimination under the Federal Crop Insurance Program.**

In the inevitable race for profit, companies engaged in price competition naturally target customers who offer the best chance of success. Experience with the current premium discount program proves that this means targeting larger farmers who buy larger policies that yield larger premiums, which will inherently carry a much better chance of providing a profit after granting a premium discount. Therefore, we conclude no rule can save the premium discounting program from being harmful to the public policy objective of the Crop Insurance Program, specifically including the proposed rule, as well as the methodology listed as an "alternative."

Therefore, the proposed rule, or any other rule, including the "alternative" proposal, developed for the purpose of implementing one Section of the law while ignoring other requirements of law will not protect the integrity of the Federal Crop Insurance Program. The RMA, acting in its capacity as an agent of the federal government and in carrying out its public policy responsibility, must indefinitely suspend any and all efforts to implement a Premium Reduction Program.

THIS RULE MAKING PROCESS HAS BEEN RENDERED A SHAM BY STATEMENTS OF RMA

In public statements by RMA management, including a statement by Associate Administrator David Hatch in a meeting with the industry on April 19, RMA has expressed a determination to publish a final rule establishing a PRP program prior to July 1, 2005 unless Congress passes a law instructing them to do otherwise. The statement was made on April 19 that RMA is compelled to do so by current law. As described in previous sections of these comments, that is a totally incorrect statement of the law. It ignores the fact that Section 508(e)(3) authorizing premium discounts does not exist in a vacuum. RMA has no authority or mandate to approve a premium discount program that is contrary to other requirements of the law and regulations. Moreover, these statements reveal an extreme bias that has characterized RMA's treatment of this issue since the beginning.

1. RMA approved the original premium discounting program with no protections against discrimination and without adequate disclosure to the Board.
2. RMA has repeatedly ignored industry complaints about the discriminatory and predatory nature of the current premium discount program.
3. RMA sought to go forward with a national premium discounting program in 2004 and suspended its efforts only when forced by the FCIC Board to conduct a notice and comment rulemaking process.
4. RMA has already made a decision that it will go forward with its PRP program regardless of the comments received in the rulemaking process, thereby rendering the process a sham.
5. RMA is ignoring the views of the entire crop insurance industry that has served the nation's farmers for many years in favor of the one premium discounting company, and comments of agents and customers of this one company.
6. RMA has neither the inclination nor the resources to prevent predatory and discriminatory practices under a PRP program. Thus it would create chaos in the marketplace.

The FCIC Board should hold RMA management accountable for failing to adhere to the Board Resolution of November 19, 2004, which called for a true notice and comment rulemaking process. See Exhibit H. What RMA has done could be done with the publication of an interim final rule. They have already determined they will ignore the many issues and legal deficiencies raised in this and other comments. They decided to ignore these comments in advance. Therefore, they have violated the Administrative Procedures Act, and any rule they issue should be challenged in the Courts.

ANY COMMENTS SECURED BY FINANCIAL INDUCEMENTS SHOULD BE IGNORED

The company that is currently engaging in premium discounting is paying its customers to send in comments supporting the proposed rule. As demonstrated in Exhibit F, farmers are being offered a pair of leather work gloves if they will send in comments in support of the rule along the lines suggested. It is a perversion of the rulemaking process to offer financial inducements to people to submit comments. Therefore, any comments along the lines of the suggestions in Exhibit G should be disqualified.

PROPOSED RULE IS INCOMPLETE; COMMENT PERIOD MUST BE EXTENDED

The proposed rule does not address at least two issues critical to any effort to implement the Section 508(e)(3) of the Act. These issues are (1) definition of "more efficiently," and (2) source and amount of resources, both human and capitol, required to enforce the proposed rule as well as the "alternative" rule.

More efficiently. Section 508(e)(3) of the Act states that for an approved insurance provider (AIP) to reduce the premium under this authority the AIP must "provide insurance more efficiently than the expense reimbursement amount..."

Efficient is defined in the dictionary as (1) acting or producing effectively with a minimum of waste, expense, or unnecessary effort, and (2) exhibiting a high ratio of output to input. This definition, as applied in business terms, is commonly interpreted to mean the ability to produce more goods and services with a given quantity of resources, or to produce the same amount of goods and services with a smaller quantity of resources. The result is that in either case the ratio of inputs to outputs is greater, hence the increased efficiency.

Simple cost cutting does not necessarily translate into business efficiency gains. To the contrary, cost cutting for the sake of generating a lower operating cost generally is known by the business community to produce less in the way of goods and services or produce goods and services of a different type or quality, which are generally less useful in some significant manner. Therefore, cutting agent commissions for the sake of generating an operating cost that is less than the A&O reimbursement level is an approach that is well known to lead to less of something in the way of either a good or a service or a combination of both. The action, by and of its self, clearly does not satisfy the definition of "more efficiently." For the federal crop insurance program, simply cutting agent commissions will result in reduced service to some farmers, even if not all farmers. But this outcome is contrary to the program mission.

The proposed rule fails to define "more efficiently." As critical as this term is to satisfying the requirements of Section 508(e)(3) of the Act, it must be fully defined. Standards of performance must be identified and AIPs properly informed regarding these requirements.

Necessary resources. The proposed rule appears to describe activities that will require substantial sums of resources, both human and capital. There is no debate about the fact that the proposed rule describes activities that extend well beyond the demand on RMA resources imposed by the current set of "guidelines" for implementing Section 508(e)(3) of the Act as it relates to the one AIP that has been approved to offer premium discounts.

If, in the unfortunate event, a final rule is promulgated to implement Section 508(e)(3) of the Act, the RMA will definitely require additional resources to make any effort at effectively managing the program. The proposed rule does not mention resource needs. In all likelihood, RMA would need to establish a fully staffed office of PRP. The increased resources must be obtained prior to publishing a final rule.

These deficiencies in the proposed rule and RMA's inability to enforce a final rule on premium discounting warrant indefinite extension of the comment period and rule making procedure.

Respectfully submitted,

Michael R. McLeod

Michael McLeod
Executive Director & General Counsel

cc: Vernon B. Parker
Assistant Secretary for Civil Rights
Members of the FCIC Board

Exhibit A

(3) The payment of the dividend, crop insurance, or patronage refund is made only to insureds.

(b) Prior to paying any dividends or patronage refunds to insureds or applicants, the covered person must certify that such payments do not violate paragraph (a) of this section. The covered person making such payments will make those financial records applicable to such payments available for inspection at the request of RMA.

(c) Payment of any dividend or patronage refund in violation of this section will result in the imposition of sanctions in accordance with § 400.757.

§ 400.754 Payments to insured-owned and record-controlling entities.

(a) Covered persons may not enter into agreements with insured-owned entities to purchase a list of producers affiliated with the insured-owned entity or an endorsement of the covered person by the insured-owned entity except as specified in this section.

(1) The covered person must request approval from FCIC in writing in accordance with paragraph (d) of this section.

(2) Covered persons may not execute agreements or make any payments to insured-owned entities until receiving written approval from FCIC.

(3) The insured-owned entity must agree in writing not to make any payments or provide any benefits to any insured or applicant affiliated with the insured-owned entity that is contingent upon the insured or applicant obtaining or maintaining insurance coverage with or through a covered person.

(4) The insured-owned entity must agree in writing that all payments made by the covered person will be deposited in the general fund to be used for the benefit of all producers affiliated with the insured-owned entity equally or in proportion to the persons interest in the insured-owned entity, as applicable.

(5) The amount of the covered persons' payment to the insured-owned entity must be a fixed amount and must not be based on the number of crop insurance policies sold to producers affiliated with the insured-owned entity or the volume of premium written.

(b) For any other type of agreement between covered persons and insured-owned entities, the covered person must comply with all the requirements of this section.

(c) A covered person is prohibited from providing any crop insurance or making any payment to a record-controlling entity unless:

(1) The covered person or the record-controlling entity provides a written request for approval for the record-controlling entity to obtain insurance or receive a payment from FCIC;

(2) The covered person or the record-controlling entity obtains the written approval from FCIC; and

(3) The covered person agrees in writing to appraise any crop under the control of the record-controlling entity and insured with or through the covered person not less than 5 days prior to harvest.

(d) All requests for approval under this section must comply with the following:

(1) All requests for approval must be received not later than 60 days prior to the date an agreement between covered persons and insured-owned entities is to be effective or, for insurance or payments for record-controlling entities, the sales closing date or payment date (requests received after the deadline will be considered for the next crop year unless the request is withdrawn by the approved insurance provider or unless FCIC otherwise agrees in writing);

(2) Each request must include the following material and address each of the following items:

(i) The name of the covered person and the person who may be contacted for further information regarding the request for approval;

(ii) A detailed description of the amounts to be paid by the covered persons and the goods or services to be provided by the insured-owned entity or record-controlling entity; and

(iii) Any other information required by FCIC.

(e) Entering into any agreement, providing insurance or making any payment under this section without the prior written consent of FCIC will result in the imposition of sanctions in accordance with § 400.757.

(f) Approval under this section will only be valid for the period specified by FCIC in its written approval.

§ 400.755 Reductions in premiums.

(a) Approved insurance providers may obtain written approval of premium reduction plans by submitting an application to RMA as follows:

(1) Applications must be received not later than 120 days before the first sales closing date on any crop for which a premium reduction is requested. Applications filed less than 120 days before the sales closing date will be considered for the next crop year unless the application is withdrawn by the approved insurance provider or unless FCIC otherwise agrees in writing.

(2) The application under this section must be sent to the Director, Reinsurance Services Division, USDA/RMA/Stop 0804, 1400 Independence Avenue, SW, Washington, DC 20250–0804.

(3) Each application must include the following:

(i) The name of the approved insurance provider, the person who may be contacted for further information regarding the application, and the person who will be responsible for administration of the premium reduction;

(ii) The crops, insurance plans, the states or counties, and all other eligibility criteria used to determine which insureds will be offered the premium reduction;

(iii) An estimate of the number of producers who will be affected, the crops, counties, and states affected, and the projected total dollar amount of the reduction;

(iv) The first crop year for which the premium reduction is proposed to be offered;

(v) A detailed description of the changes in administrative and operating procedures that produce the efficiency and a detailed cost-accounting statement verifying the existence and the amount of the efficiency (Both statements must be certified by the person authorized to sign the Standard Reinsurance Agreement for the approved insurance provider. The cost-accounting statement must include historical data that permits a comparison of administrative and operating costs before and after the introduction of the new procedures. Estimates may be supplied whenever the procedures have not yet been implemented or have not been implemented long enough to permit the proper collection of cost accounting data);

(vi) A description and an example as to how the approved insurance provider will calculate the premium reduction and present it to eligible insureds;

(vii) A description of those features of the proposed premium reduction plan that will assure that it will not discriminate against small producers, limited resources farmers as defined in section 1 of the Basic Provisions, 7 CFR 457.8, or minority producers.

(viii) A narrative statement explaining how the application satisfies all applicable approval criteria specified in § 400.755; and

(ix) Any other information that the approved insurance provider wishes to submit or that is required by FCIC.

(b) Compliance with all the following criteria is required for FCIC's approval:

(1) All required information must be timely submitted;

(2) There must not be a reduction in service to policyholders;

(3) There must not be a reduction in training and supervising of agents, loss adjusters, or underwriting and quality assurance personnel;

(4) There must not be a reduction in program integrity or an adverse affect on actuarial soundness;

(5) There must not be a reduction in the total delivery system's ability to serve all producers, including small producers, limited resource farmers as defined in the Basic Provisions, 7 CFR 457.8, minority producers, and producers located in areas with small volumes of crop insurance business;

(6) There must not be a reduction in the total delivery system's ability to provide risk management education to all producers;

(7) The efficiency must be measurable in dollar terms;

(8) RMA must be able to verify the existence and amount of the efficiency and that it is derived from the administrative and operating subsidy and not any expected underwriting gain;

(9) The efficiency must not derive from marketing or underwriting practices that are unfairly discriminatory; such as discriminating among producers on the basis of farm size or premium amount; and

(10) The premium reduction must not jeopardize or diminish the financial condition of the approved insurance provider.

(c) Each application will be reviewed to determine if all necessary documentation is included. FCIC may require changes or adjustments to the application consistent with the Act and FCIC's regulations.

(d) An application to reduce premium will not be approved if FCIC determines that it will discriminate against small producers, limited resources farmers as defined in section 1 of the Basic Provisions, 7 CFR 457.8, or minority producers.

(1) If the insurance provider proposes to offer the premium reduction to an identifiable group of producers or in a specific geographical area, then the premium reduction must be made available to all producers in that group or area, regardless of the amount of premium to be earned on the producer's policy.

(2) No group or geographical area may be defined in such a manner as to exclude small producers, limited resource farmers, or minority producers.

(e) The Director of the Reinsurance Services Division will notify the approved insurance provider of the action taken.

(1) If the application is disapproved, the approved insurance provider:

(i) Will be notified of the reason for disapproval and will be allowed to amend the application in an effort to obtain FCIC's approval. If the approved insurance provider amends the application, the review process starts again and it may not be possible to approve the application in time to have it applicable for the crop year for which such application was submitted; and

(ii) May request reconsideration of the decision with the Deputy Administrator of Insurance Services within 30 days of disapproval. Such request must provide a detailed narrative of the basis for reconsideration.

(2) Approval is solely within the discretion of FCIC.

(3) An approved application may be implemented by the approved insurance provider by the next sales closing date for the affected crop after approval by RMA.

(4) Approved applications for premium reduction will only be valid for the period specified by RMA.

(5) FCIC may rescind any approval at any time that it determines that the requirements imposed by this rule are no longer satisfied or if a change in the Act necessitates rescission. In such case, rescission will not take effect earlier than the date of FCIC's written notice to the approved insurance provider.

(6) The approved insurance provider must report all changes causing a material impact upon a previously-approved application to the Director of the Reinsurance Services Division.

§ 400.756. Records and Review.

At any time after approval, RMA may conduct a review or audit of any action approved under this subpart and require additional information or access to records pertaining to such actions. Failure to comply with this section will result in the impositions of sanctions in accordance with § 400.757.

§ 400.757 Sanctions.

(a) No crop insurance policy in violation of this subpart will be eligible for reinsurance, premium subsidy, or administrative and operating expenses. If reinsurance, premium subsidy, or administrative and operating expenses have been paid for such policy, they must be repaid to FCIC.

(b) Approved insurance providers are responsible for the conduct of all of their covered persons. If such covered person violates any provision in this subpart, the approved insurance provider will be held strictly liable.

Signed in Washington, DC, on May 4, 1999.

Kenneth D. Ackerman,

Manager, Federal Crop Insurance Corporation.

[FR Doc. 99–11759 Filed 5–11–99; 8:45 am]

BILLING CODE 3410–08–P

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Chap. I

[Docket No. 99–05]

Community Bank-Focused Regulation Review

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is undertaking a review of its regulations with a view toward identifying rules that may impose disproportionate or unnecessary burden on community banks. This advance notice of proposed rulemaking (ANPR) identifies several parts of the OCC's regulations that are already under review, requests comment on changes that could be made to these regulations, and solicits suggestions for improvements in other areas that would be helpful to community banks. The intended effect of this action is to identify areas where the OCC could reduce unnecessary burden on community banks without impairing their safety and soundness.

DATES: Comments must be received by July 12, 1999.

ADDRESSES: Please direct your comments to: Docket No. 99-05, Communications Division, Third Floor, Office of the Comptroller of the Currency, 250 E Street, SW, Washington, DC, 20219. You can inspect and photocopy all comments received at that address. In addition, you may send comments by facsimile transmission to FAX number (202) 874–5274, or by electronic mail to REGS.COMMENTS@OCC.TREAS.GOV.

FOR FURTHER INFORMATION CONTACT: Stuart Feldstein, Assistant Director, or Heidi Thomas, Senior Attorney, Legislative and Regulatory Activities, at (202) 874–5090.

SUPPLEMENTARY INFORMATION:

Background

The OCC supervises over 2,400 national banks that vary widely in size, business strategy, complexity, and

Exhibit B

Board Memorandum No. 694
Docket No. CI-PDP-02-1
PDP - Submitted by Converium Insurance North America, Inc., and Crop1 Insurance Direct, Inc., Beginning with the 2003 Crop Year

FINAL RESOLUTION

RESOLVED, That Docket No. CI-PDP-02-1, Exhibit No. 2152, authorizing implementation of the PDP business plan under section 523(b) of the Federal Crop Insurance Act (Act) is withdrawn and resubmitted under section 508(e)(3) of the Act AND BE IT FURTHER RESOLVED, That the Board recommends that the PDP business plan be approved by the Corporation subject to the following rules, limitations and procedures:

(1) All questions that have been posed to the expert reviewers are adequately addressed, as determined by the Corporation;

(2) The submitter can demonstrate that it can reduce its costs by a specific amount through an efficiency in the delivery of the Federal crop insurance program;

(3) The efficiency employed by the submitter to reduce its costs does not result in a reduction of service to policyholders;

(4) The submitter can demonstrate that it has the financial capacity to deliver the PDP business plan, as determined by the Corporation, in the areas in which it has been proposed, or approved by the Corporation;

(5) That the PDP business plan be offered on a limited basis, to be determined by the Corporation, and expanded over time as the capacity and ability of the submitter to deliver the PDP business plan is established, as approved by the Corporation;

(6) That the submitter and the Corporation shall monitor the performance of the PDP business plan and that the submitter provide weekly reports to the Corporation regarding the performance of the PDP business plan and report any problems discovered;

(7) That the Corporation report to the Board at each Board meeting the performance of the PDP business plan during the period since the previous Board meeting;

(8) That the Corporation can take such action as necessary, including the withdrawal of approval, if the Corporation determines that any condition herein has not been fully and satisfactorily met, and continues to be met during the duration of the PDP business plan, or that may be needed to protect the integrity of the program, as determined by the Corporation; and

(9) That the conditions stated herein be applied to all submitters of plans or proposals for premium reduction governed by section 508(e)(3) of the Act.

Adopted by the Board of Directors on: December 18, 2002

/s/ Diana Moslak
Diana Moslak, Secretary
Federal Crop Insurance Corporation

[SEAL]

Approved by:

/s/ Keith Collins
Keith Collins
Chairman of the Board

12/18/02
Date

Exhibit C

United States Department of Agriculture
Farm and Foreign Agricultural Services
Risk Management Agency

May 1, 2003

BULLETIN NO.: MGR-03-008

TO: All Reinsured Companies
All Risk Management Agency Field Offices
All Other Interested Parties

FROM: Ross J. Davidson, Jr. /s/ Ross J. Davidson, Jr.
Administrator

SUBJECT: Procedures for Submitting Premium Reduction Plans

BACKGROUND:

Section 508(e)(3) of the Federal Crop Insurance Act authorizes approved insurance providers (AIP) to reduce the amount of premium charged an insured on Federally-reinsured crop insurance, if the AIP determines that it can provide insurance more efficiently than the expense reimbursement amount established by the Federal Crop Insurance Corporation (FCIC). The AIP must make application to, and obtain approval from the FCIC prior to making any premium reduction available to a producer.

ACTION:

The attached procedures establish the submission criteria for AIP's making application for offering premium reduction plans pursuant to section 508(e)(3) of the Act. These procedures are available on the RMA website at:

www.rma.usda.gov/news/managers/2003/pdf/008/Premium_Reduction_Application_Procedures.pdf.

DISPOSAL DATE:

This Manager's Bulletin is for the purpose of transmitting information and the expiration date is December 31, 2003.

1400 Independence Ave., SW . Stop 0801 . Washington, DC 20250-0805

Procedures For Premium-Reduction Application

Contents:

I. Definitions.

Act – The Federal Crop Insurance Act (7 U.S.C. 1501 et seq.).

Administrative and Operating (A&O) Costs – Costs of the AIP and any MGA and TPA that are related to the delivery, loss adjustment and administration of the Federal crop insurance program.

Administrative and Operating (A&O) Subsidy - The subsidy for the administrative and operating expenses authorized by the Act and paid by FCIC on behalf of the producer to the Company.

Affiliate – A person or entity, excluding agents, loss adjusters, and employees of the AIP, that enters into partnership or other relationship with an AIP for the purpose of assisting the AIP in making the premium-reduction plan available to producers.

Agent - An individual licensed by the State in which the agent does business under contract with a Company, its managing general agent, or any other entity, to sell and service eligible crop insurance contracts. Agents may represent a single AIP or multiple AIP's.

Application – A written request to RMA, along with all required supporting documentation, submitted by an AIP for the purpose of obtaining approval to reduce insured's premium in accordance with section 508(e)(3) of the Act.

Approved Insurance Provider (AIP) – An insurance company that has been approved by FCIC to sell and service crop insurance policies reinsured by FCIC under the Act.

Compensation – Any salary, commission or any other payment, or thing of value or benefit that has a quantifiable value, including, but not limited to, the payment of health or life insurance, deferred compensation (including qualified and unqualified), finders fees, retainers, trip or travel expenses, dues or other membership fees, the use of vehicles, office space, equipment, staff or administrative support.

Cost-Accounting Statement – An accounting of all of the AIP's A&O costs, identifying and quantifying the efficiency that the AIP expects to realize, and showing the results of the immediate prior year and comparing them to the estimated results of the current or the following year. The estimated accounting shall be for the year in which the proposed premium reduction is to take place.

Efficiency – Monetary savings realized when an AIP sells and services its Federal crop insurance policies for less than only the amount of the A&O subsidy paid by FCIC, which may result from changes to the administrative and operating procedures that the AIP employs in delivering Federally-reinsured policies in accordance with the Act, the SRA, and all applicable regulations, directives, bulletins and procedures, or from reductions in compensation provided to its owners, employees, agents, loss adjusters and other service providers. Efficiency does not include any actual or projected underwriting gain earned from the SRA or the investment returns on the AIP's reserves.

Federal Crop Insurance Corporation (FCIC) – A wholly-owned government corporation within the United States Department of Agriculture, whose programs are administered by RMA.

Producer Premium – The portion of the FCIC-approved insurance premium for the risk of loss that the policyholder must pay.

Managing General Agent (MGA) – An entity that meets the definition of managing general agency under the laws and regulations of the State in which the AIP is incorporated, or in the absence of such definition, the definition in the Managing General Agents Model Act, as published by the National Association of Insurance Commissioners. The entity must comply with the managing general agency laws and regulations, if applicable, of each State in which the entity operates.

Premium Reduction – Reduction of the insured's premium by the AIP in an amount corresponding to the amount of the efficiency, in accordance with section 508(e)(3) of the Act, all applicable regulations, and these procedures.

Risk Management Agency (RMA) – An agency of the United States Department of Agriculture, which administers the programs of the FCIC.

Sales Closing Date – The date established by FCIC as the last date on which a producer may apply for an eligible crop insurance contract on a crop in a specific county.

Standard Reinsurance Agreement (SRA) – The reinsurance agreement between FCIC and the AIP, under which the AIP is authorized to sell and reinsure the policies for which premium reduction is proposed.

Third Party Administrator (TPA) - A person or organization that processes claims or performs other administrative services and holds licenses, as applicable, in States in which services are provided with respect to the Federal crop insurance business in accordance with a service contract or an affiliate or any other type of relationship.

Unfair Discrimination – A premium- reduction plan will be considered unfairly discriminatory to producers if it is based on the loss history of producers or precludes in any manner other producers of an approved crop and in an approved State from participating in the program.

II. Basis, Purpose, And Applicability

This document provides procedures that are applicable to applications submitted by AIPs for the purpose of obtaining approval for a premium-reduction plan in accordance with section 508(e)(3) of the Act and section III. D. of the SRA. The offering of such premium-reduction plans without RMA's written prior approval is prohibited.

III. Timing Of Application

(a) Applications must be received and deemed complete by RMA not later than 150 days before the first sales closing date (120 days for the September 30, 2003 sales closing date) on any crop for which a premium reduction is requested.

(b) If RMA determines there is insufficient time to complete the approval process, train agents and permit sales under the premium-reduction plan, complete applications filed less than 150 days before the first sales closing date (120 days for the September 30, 2003 sales closing date) may be considered.

IV. Confidentiality Of Application

Any confidential commercial or financial information submitted with an application will be protected from disclosure to the extent permitted by, and in accordance with, 5 U.S.C. 552(b)(4).

V. Contents Required For An Application

An application must contain the following material, in the order given, and be contained in a 3-ring binder with section dividers clearly labeling each section. The submission must also include computer disks or other electronic media in a format acceptable to RMA, a duplicate of the materials submitted in the binders. Each application must include five identical copies and be sent to the Director of Reinsurance Services (or designee), Risk Management Agency, 1400 Independence Avenue S.W., AgStop 0805, Washington, DC 20250.

(a) The name of the AIP, the person(s) who may be contacted for further information regarding the application, and the person(s) who will be responsible for administration of the premium reduction;

(b) The proposed crops and States where the efficiency is being gained and where the premium-discount plan will be available, reinsurance year the premium-reduction plan will be in effect, the projected total dollar amount of the efficiency and an estimate of the number of producers affected;

(c) A statement as to the amount of the premium reduction that is proposed to be offered to each eligible producer and how it will be calculated; the crop(s) and state(s), for which it will be provided (must correspond to the crop(s) and state(s) where the efficiencies are gained); and a list of any and all terms and conditions that affect its availability;

(d) A statement of how the premium reduction will be calculated and presented to producers and reported to RMA;

(e) A detailed statement explaining how the AIP proposes to revise its procedures for the delivery, operation or administration of the Federal crop insurance program in order to achieve the specified efficiency and an explanation of how and to what extent such revision will actually achieve the efficiency;

(f) Provide materials demonstrating that the AIP can attain the specified efficiency and that the AIP has the financial capacity and necessary resources to adequately sell and service the Federally-reinsured policies that it has proposed to sell in its Plan of Operations, given the proposed premium reduction. At a minimum, the following must be provided:

(1) A detailed statement of efficiencies, supported by a comparison of the cost accounting statement and a statement of the use of A&O subsidy received under the SRA, detailed by expense category before and after the application of the efficiencies.

(2) There may be instances where a new AIP is entering into the crop insurance program or an existing AIP may anticipate a growth in business as a result of the implementation of a premium-reduction plan during which the AIP incurs greater-than-normal costs (e.g. first-time marketing costs, IT system purchases). In those instances, the costs that are associated with getting the crop insurance business operational or the changes to the operation necessary to be able to service the increased volume of business may be included in the A&O costs for the purpose of determining the efficiency. For AIPs that meet this criteria, as determined by RMA, the following will apply:

(A) The costs associated with the entry into the program or growth should be accounted for separately from all other A&O costs.

(B) New AIPs should provide, for the states and crops where the premium reduction plan will be made available for the reinsurance year, a separate estimate of:

(i) The A&O costs associated with entry into the crop insurance business; and

(ii) All other A&O costs.

(C) Existing AIPs should provide, for the states and crops where the premium reduction plan will be made available for the reinsurance year:

(i) An estimate of the A&O costs associated with the anticipated growth; and

(ii) An accounting of all other actual A&O costs.

(D) The amount of the efficiency for the reinsurance year will be determined by:

(i) Subtracting the A&O costs associated with entry into the program (see (B)(i)) or growth (see (C)(i)) from the total of all A&O costs ((B)(i) + (B)(ii) or (C)(i) + (C)(ii), as applicable); and

(ii) Subtracting the result of (D)(i) from the A&O subsidy for the reinsurance year for the states and crops where the premium reduction plan will be made available.

(3) Detailed accounting statements prepared in a manner that permits comparison with the Expense Exhibit that the AIP submits to RMA annually with its Plan of Operations. A certified public accountant must certify to the reasonableness, accuracy, and completeness of the statement. If the AIP employs an MGA and/or TPA, the statement must present the specified information for the AIP and as applicable, the MGA and/or TPA.

(4) Actual expenses must be submitted for the quarter immediately preceding the proposed premium reduction as support for the AIP's actual estimated expenses. (In addition, RMA may request an estimated monthly cash flow worksheet for a full year containing a detailed description of expenses and income related to the proposed premium reduction plan.)

(5) The compensation (as defined in this procedure) to be paid to agents by state and amount of premium written before and an estimate of premium written after the introduction of the efficiency.

(6) A detailed review by the AIP of the potential impact the premium-reduction plan may have regarding the following, and the steps that will be taken to address any potential vulnerabilities:

(A) The operational capacity of the AIP; and

(B) The level of market penetration of the Federal crop insurance market in the proposed crop(s) or State(s).

(C) The ability of the AIP to service all policy holders, including the timely adjustment of claims.

(7) If the AIP employs an MGA, it shall certify that it's contract with the MGA contains the following language, and that the contract between the MGA and all sub-general agents contain similar language granting the same rights to intervene to the AIP. RMA may, at its sole discretion, accept minor modifications to the following language in order to accommodate specific circumstances.

"The ***(insert AIP's name)*** *(Company) and* ***(insert MGA name)*** *(MGA), as a condition for obtaining approval of a premium reduction plan from the Federal Crop Insurance Corporation (FCIC), which is of mutual benefit to both the Company and the MGA do hereby agree as follows:*

"In the event that the MGA becomes unable to service the multi-peril crop insurance (MPCI) policies reinsured by FCIC, the MGA shall provide to the Company complete and unlimited access to all of its facilities, files, data systems (including all of the MGA's computer hardware and software programs and applicable licenses), personnel, and related resources and equipment to allow the Company itself and/or the Company's designee(s) to administer directly, in full compliance with all applicable Federal laws, rules and manuals, all aspects of the Company's MPCI policies and claims which the MGA has agreed to service and for which the Company is ultimately responsible. It is understood that the Company, as the holder of a Standard Reinsurance Agreement with the FCIC, shall have sole discretion to determine whether the MGA has become unable to service the MPCI policies or claims at issue. It is further understood, however, that such discretion shall be exercised in good faith and shall be preceded by written notice, which shall be given in as practical a time frame as the particular circumstances permit to both the MGA and the FCIC. Prior to exercising such direct administration, the Company shall grant the MGA ten business days from the date of the Company's written notice to allow the MGA to take remedial or preventative action. Such remedial or preventative action must be completely satisfactory in the Company's judgment, and such judgment shall be exercised in good faith."

(8) An opinion by the AIP's legal counsel that all persons or entities involved with the delivery of the premium-reduction plan, including affiliates, are in compliance with applicable state insurance laws regarding licensing of agents and the conduct of agents in the solicitation and sale of insurance.

(g) An analysis of whether or not the proposed premium-reduction plan may be unfairly discriminatory, or potentially perceived to be discriminatory, and if so, what remedies the AIP has to address such situations.

(h) Any other information that will assist RMA in determining if the application satisfies the criteria for approval.

VI. RMA Review

(a) Each application will be reviewed by RMA to determine if all necessary and appropriate documentation is included. The applicant will be notified within thirty (30) days after receipt of the premium-reduction plan if the submission does not comply in all material respects with these requirements. RMA will return the premium-reduction submission to the applicant after notification. Any returned application must be resubmitted in its entirety unless otherwise determined by RMA.

(b) Upon completion of the RMA staff review, all recommendations will be forwarded to the Administrator of RMA (or designee), who will approve or disapprove the application.

(c) In addition to the written application, RMA may require the AIP to make an oral presentation to RMA.

(d) After the AIP establishes that it has the ability and capacity to deliver the premium-reduction plan, the AIP may request expansion of the program in accordance with these procedures.

(e) RMA will notify the applicant at least 60 days before the applicable sales closing date of its approval or disapproval of the submitted premium reduction plan.

VII. Criteria For Approval

RMA may approve the application if, in the sole determination of RMA, the application demonstrates that the following criteria are met:

(a) The AIP can reduce A&O costs by a specific amount through efficiencies in the delivery of the Federal crop insurance program;

(b) The premium-reduction plan will not result in a reduction of service to policyholders or be harmful to the interests of producers;

(c) The premium-reduction plan is not unfairly discriminatory;

(d) Implementation of the premium-reduction plan does not place financial or operational hardship on the AIP, RMA, or potentially undermine the integrity of the Federal crop insurance program;

(e) The AIP has the financial and operational capacity and expertise to properly deliver the Federal crop insurance program once the premium-reduction plan is implemented;

(f) The AIP's resources, procedures, and internal controls are adequate to make the premium-reduction plan available to producers in a timely manner and to protect the integrity of the Federal crop insurance program, including the prevention of fraud, waste and abuse; and

(g) The premium-reduction plan meets all other relevant requirements of the Act and the SRA.

VIII. Disapproval

(a) RMA will disapprove any application that:

(1) Does not meet the approval criteria stated in section VII or any other requirement in these procedures;

(2) Where the documentary evidence provided does not support the existence or amount of the efficiency or costs.

(b) If RMA disapproves an application, it will notify the AIP in writing of its disapproval and provide reasons for such disapproval.

IX. Terms And Conditions For Approved Premium-Reduction Plans

The following terms and conditions apply to all AIPs whose applications are approved:

(a) All procedural issues, questions, problems or clarifications with respect to implementation of the premium-reduction plan must be promptly addressed by the AIP.

(b) The AIP must implement the premium-reduction plan in accordance with the terms and conditions of approval.

(c) The AIP must provide quarterly reports or more frequently as determined appropriate by RMA, that permit RMA to accurately evaluate the effectiveness of the premium-reduction plan, and the financial and operational condition of the AIP, in the manner specified by RMA;

(d) The AIP must provide special reports of any information required by RMA to evaluate the functioning of the premium-reduction plan, as requested by RMA.

(e) The AIP is solely liable for all damages caused by any mistakes, errors, misrepresentations, or flaws in the premium-reduction plan.

(f) The AIP must assist RMA in its periodic review of the operations of the AIP for the purpose of assuring that the efficiency is generated and the premium-reduction plan is administered in the manner presented in the application, that the solvency and operational capacity of the AIP, remain unimpaired, and that the interests of producers and taxpayers are protected.

(g) AIP must allow any insured to refuse to participate in the premium-reduction plan through the execution of a written waiver. After execution of the waiver, the AIP may elect to offer insurance for the full amount of the premium.

(h) The AIP agrees to make any substantive changes requested by RMA in the application or its implementation of the premium-reduction plan to ensure compliance with the Act, regulations, the SRA and any applicable policy provisions and approved procedures, and to protect the interests of producers and taxpayers, and the integrity of the program.

(i) An AIP offering a premium-reduction plan must submit in its annual Plan of Operations, an accounting of the full actual A&O costs associated with operation of the premium-reduction plan incurred during the most recent reinsurance year in which the premium-reduction plan was in effect. In any subsequent reinsurance year, the amount of efficiency that may be used in a premium reduction will not exceed the actual cost savings obtained for the previous reinsurance year unless the AIP can demonstrate additional cost savings.

(j) RMA may, at its sole discretion, withdraw or modify, effective upon notice, its approval of any premium-reduction plan if RMA determines that it no longer satisfies the criteria for approval; the AIP fails to comply with one or more of the terms and conditions of approval; the stated efficiencies have not realized; any other terms and conditions in these procedures have not been fully and satisfactorily met; or the integrity of the FCIC program is jeopardized in any way, as determined by RMA, by the premium-reduction plan as actually implemented. RMA, at its discretion, may grant a reasonable period of time for the AIP to remedy any discrepancy, flaw, mistake, error or misrepresentation in the premium-reduction plan.

Exhibit D

Side-by Side Comparison of Protections for Small Farmers, Limited Resource Farmers, Minority Farmers, and Farmers in Low Volume Areas, of the 1999 Proposed Rules and the 2003 Manager's Bulletin Regarding Premium Reduction Plans

Section 508(e) (3) of the Federal Crop Insurance Act (7 U.S.C. 1501 *et seq.*) states;

> If an approved insurance provider determines that the provider may provide insurance more efficiently than the expense reimbursement amount established by the Corporation, the approved insurance provider may reduce, subject to the approval of the Corporation, the premium charged the insured by an amount corresponding to the efficiency. The approved insurance provider shall apply to the Corporation for authority to reduce the premium before making such a reduction, and the reduction shall be subject to the rules, limitations, and procedures established by the Corporation.

Proposed Rules May 12, 1999 Fed. Register Vol. 64. No.91. pg 25466 – Never Finalized After Public Comment Period (emphasis added)	**May 1, 2003 Manager's Bulletin MGR-03-008 – Expired 12/31/03, reinstated 10/6/04**	
	RMA may approve the application if, in the sole determination of RMA, the application demonstrates that the following criteria are met:	
§ 400.755 (b)(2) There must not be a reduction in service to policyholders;	**VII. (b)** The premium-reduction plan will not result in a reduction of service to policyholders or be harmful to the interests of producers;	
§ 400.755 (b)(3) There must not be a reduction in training and supervising of agents, loss adjusters, or underwriting and quality assurance personnel;		
§ 400.755 (b)(5) There must not be a reduction in the total delivery system's		

ability to serve all producers, **including small producers, limited resource farmers as defined in the Basic Provisions, 7 CFR 457.8, minority producers, and producers located in areas with small volumes of crop insurance business;**		
§ 400.755 (b)(6) There must not be a reduction in the total delivery system's ability to provide risk management education to all producers;		
§ 400.755 (b)(9) The efficiency must not derive from marketing or underwriting practices that are unfairly discriminatory; **such as discriminating among producers on the basis of farm size or premium amount; and**	**VII. (c)** The premium-reduction plan is not unfairly discriminatory; **I. Unfair Discrimination** A premium-reduction plan will be considered unfairly discriminatory to producers if it is based on the loss history of producers or precludes in any manner other producers of an approved crop and in an approved State from participating in the program.	
§ 400.755 (d) An application to reduce premium will not be approved if FCIC determines that it will discriminate against small producers, limited resources farmers as defined in section 1 of the Basic Provisions, 7 CFR 457.8, or minority producers.		
(1) If the insurance provider proposes to offer the premium reduction to an identifiable group of producers or in a specific geographical area, then the premium reduction must be made available to all producers in that group or area, regardless of the amount of premium to be earned on the producer's policy.		

(2) No group or geographical area may be defined in such a manner as to exclude small producers, limited resource farmers, or minority producers.		
§ 400.757 Sanctions.		
(a) No crop insurance policy in violation of this subpart will be eligible for reinsurance, premium subsidy, or administrative and operating expenses. If reinsurance, premium subsidy, or administrative and operating expenses have been paid for such policy, they must be repaid to FCIC.		

Exhibit E

Thursday, January 16, 2003

Backgrounder: Premium Discount Plan (PDP)

In section 508(e) of the Federal Crop Insurance Act (Act), Congress envisioned the development of a program whereby insurance providers who could show a specific savings in the delivery of the crop insurance program, without adversely affecting the service to policyholders, could pass that savings to their policyholders in the form of reduced premium.

The Federal Crop Insurance Corporation (FCIC) Board of Directors' review of the Premium Discount Plan (PDP) was rigorous. The FCIC Board of Directors' wanted to ensure that Converium Insurance North America, Inc. (CINA) and its managing general agent, Crop1, had the systemic ability to deliver the program, had the financial capacity to underwrite the policies in the proposed areas, and that program integrity and service to policyholders would not be adversely affected. Five independent reviewers as well as several Board members raised a number of issues that were then satisfied by Crop1 and CINA. The Board also placed a number of restrictions on the program, including limiting the number of states and crops in which the discount could be offered to allow the program to be tested.

Approval of Crop1's proposal does not limit other insurance companies from developing and submitting similar proposals for Board review, as long as the criteria set forth in the Act and established by the Board are met.

Under PDP, sales and service are primarily conducted online via Crop1's internet site. Crop1 has established a network of affiliates (such as seed dealers, implement dealers, and farm creditors) to assist producers. Crop1 has also established an online chat service where producers can initiate online instant messaging with a licensed agent. Crop1 employs full-service agents to assist producers if an on-farm visit is necessary. While Crop1's concept of direct sales via the internet is new to crop insurance, other lines of casualty insurance have been direct marketed via the internet for years. The Freedom to E-File Act mandated that RMA and the FCIC through approved insurance providers, enable agricultural producers to access all forms and other program information via the Internet and provide for the electronic filing of all required program paperwork. Crop 1's PDP implementation complies with this requirement.

Related item: Board Memorandum No. 694: Final Resolution (PDF file)

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Last Updated: Wednesday, 15-Jan-2003 17:53:08 Central Standard Time

Exhibit F

Pigford v.Veneman: Consent Decree in Class Action Suit by African American Farmers

STATISTICS ON CLAIMS April 6, 2005

Claims reviewed under Consent Decree	22,370
Claims accepted by Facilitator for processing in **Track A**	22,223
Information from USDA submitted to Adjudicator	22,188
Information from USDA not yet submitted to Adjudicator	35
Claims accepted by Facilitator for processing in **Track B**	182
Claims rejected by Facilitator for processing (not class member)	1,065
Track A:	
Adjudicator's determinations completed	22,190
Rulings against claimant	8,307 (39%)
Rulings in favor of claimant	13,883(63%)
Eligible to receive $50,000 payment from Department of Justice	13,661
$50,000 payments made to claimant by Department of Justice **Total amount paid**	13,543 **$677,150,000**
Claimants with loans identified for cancellation **Total number of loans**	1322 **3,474**
Claimants with loans identified for cancellation which still had a balance owed **Total number of loans**	225 **459**
Claimants whose loans were cancelled **Total amount cancelled**	486 **$20,253,961.70**
Claimants who received an offset refund	68

Total amount refunded	$265,676.55

Exhibit G

crop1 INSURANCE

1st in savings

FIND OUT HOW YOU CAN RECEIVE FREE LEATHER WORK GLOVES

<Customer Name and Address>

Dear <First Name>:

Thank you for choosing <Agency Name> and Crop1 to service your crop insurance needs for 2005. We are excited to be able to offer your farming operation real savings with the Crop1 Premium Discount Plan (PDP).

We believe in the PDP plan, and have proof that thousands of producers, like yourself, want to see us continue the program. The USDA and FCIC have proposed a new Rule which allows you to continue to buy FCIC crop insurance at reduced costs. If the Rule fails, Crop1's PDP could be eliminated and the price you pay for FCIC crop insurance will go up. Attached is more information about how we can be proactive and save PDP. **Please note, though, we only have until April 25th to respond.**

Would you please email RMA at RMA.PRP@rma.usda.gov ASAP to explain how PDP has saved you money and that you want to see it continued. As an added bonus, if you respond by email with a copy to Crop1 at (sales@crop1insurance.com), we will mail you a free pair of leather work gloves.

For those of you who do not have access to email, please feel free to mail your comments to:

Director, Reinsurance Services, RMA, USDA,
1400 Independence Avenue, SW, Mailbox 0805
Washington, DC 20250

Again, if you send Crop1 a copy of your letter, we will mail you a free pair of leather work gloves. Don't hesitate to contact us at <phone number> with questions. We look forward to hearing from you and having the opportunity to offer PDP in the future.

Thank you in advance for your assistance,

<Agency's Name>
and
Crop1 Insurance

Enclosures

4532 114th Street - Des Moines, Iowa 50322
phone 866-765-0552 *(toll free)* fax 866-765-0553 *(toll free)* www.crop1insurance.com

crop
INSURANCE

1st for savings

1. Introduce yourself ... with answers to questions like how many acres you farm, what crops you grow and what insurance products and level of coverage you usually choose for your FCIC-guaranteed insurance?

2. Tell USDA that you support CFR Citation 07 CFR 400 and want the right to save money on your FCIC-guaranteed crop insurance. Include comments like:
   - I saved "x" dollars on my FCIC-guaranteed crop insurance bill last year when I bought from my Crop1 agent who offered me the Crop1 Premium Discount Plan (PDP).
   - I used the money saved to buy a higher level of coverage.
   - This made my banker happy, too.
   - I have the right to shop insurance prices for coverage and service for my other kinds of property-casualty insurance. There isn't any reason why I shouldn't be allowed to choose my crop insurance provider based on price as well as service, too.

3. If you've had a loss while buying your insurance with Crop1's PDP, include a comment about the loss and how pleased you were that the adjustor came promptly and so did the indemnity check.

ONE LAST REMINDER ... THE DEADLINE FOR RESPONSE IS NEAR.

PLEASE TAKE TIME TO WRITE YOUR EMAIL TODAY.

DEADLINE FOR COMMENT IS April 25, 2005. Without your comment, your savings on FCIC-guaranteed crop insurance are likely to be eliminated.

THANK YOU

PS: Would you please copy us at Crop1 at sales@crop1insurance.com, so we know that you've commented and we can remind USDA that your support is important? *Thanks again.*

Crop1 Insurance

1st in savings

LEGISLATIVE ALERT!! USDA and the Federal Crop Insurance Corporation (FCIC) have proposed a new Rule, which allows you to continue to buy FCIC crop insurance at reduced costs. <u>This Rule deserves your support.</u>

WHAT'S AT STAKE? If the Rule fails, or is changed significantly, Crop1's Premium Discount Plan (PDP) could be eliminated, and the price you pay for FCIC crop insurance will go up.

WHERE AND HOW CAN I COMMENT?

Proposed Rule: CFR Citation 07 CFR 400

Deadline for Comment: April 25, 2005

How to Comment – Email comments to the following web address: RMA.PRP@rma.usda.gov

You may also mail a letter to the following address: Director, Reinsurance Services, RMA, USDA, 1400 Independence Avenue, SW, Mailbox 0805, Washington, DC 20250.

BACKGROUND:
The Risk Management Agency, on behalf of the Federal Crop Insurance Corporation (FCIC), is considering new regulations as to how and whether FCIC crop insurance can be offered for sale at reduced prices.

The Proposed Rule is called: CFR Citation 07 CFR 400.

This Rule affects the Crop1 Premium Discount Plan (PDP) and whether farmers can continue to buy FCIC-guaranteed crop insurance at competitive prices. Right now, the proposed Rule both protects Crop1's ability to save you money on your crop insurance bill, and also allows more companies to offer you savings.

Crop1 supports the proposed Rule, which will institutionalize your right to choose your crop insurance from companies that both give you good service on your policies, and also offer you the lowest prices possible for FCIC insurance.

TIME IS SHORT – EMAIL RMA TODAY AT RMA.PRP@rma.usda.gov

Here are some suggestions for "talking points." <u>Remember to write in your own words.</u>

4532 116th Street - Des Moines, Iowa 50322
Phone 866-765-6332 (toll free) Fax 866-765-0533 (toll free) www.crop1insurance.com

Exhibit H

<u>FINAL RESOLUTION</u>

Premium Reduction Plan Resolution, Exhibit No. 2772

WHEREAS, on October 28, 2004, the Board adopted a resolution to publish an advanced notice of proposed rulemaking seeking advice of the public on issues related to Premium Reduction Plans;

WHEREAS, the Risk Management Agency (RMA) has conducted further review, since the October 28, 2004, Board meeting, of the manner in which the Premium Reduction Plan requirements should be reviewed and modified and now recommends that RMA immediately proceed with notice and comment rulemaking on this matter;

WHEREAS, Notice and comment rulemaking would give the public a better opportunity to provide comments and analysis in the development of the Premium Reduction Plan requirements if it is given the opportunity to comment on a proposed rule;

THEREFORE RESOLVED, that the resolution adopted by the Board on October 28, 2004, Exhibit No. 2769, regarding issues related to proposed Premium Reduction Plans be rescinded and that the Board adopt the following resolution in its place:

"WHEREAS, Issues have been raised regarding the legality of the current Premium Reduction Plan procedures;

WHEREAS, Issues have been raised regarding the effect of the Premium Reduction Plan on the crop insurance delivery system;

WHEREAS, Issues have been raised regarding the effect of the Premium Reduction Plan on all farmers including small, minority, and limited resource farmers.

WHEREAS, Issues have been raised regarding the equity of the Premium Reduction Plan procedures as they apply to small and large approved insurance providers; and

WHEREAS, Implementation issues have been raised by the new submissions that were not contemplated when the procedures were drafted;

THEREFORE, RESOLVED THAT the Board now directs the Federal Crop Insurance Corporation (FCIC) to publish a Proposed and Final Rule to address the above stated and other issues as identified by FCIC, as expeditiously as possible."

Adopted by the Board of Directors on: <u>11/19/04</u>

/signed/ 11/19/04
Byron Anderson Date
Secretary
Federal Crop Insurance Corporation

[SEAL]

Approved by:

/signed/ 11/19/04
Keith Collins Date
Chairman of the Board

Appendix B

SHERRY WEGNER AGENCY/GLASSCOCK BRANCH

CROP YEAR 2004

TOTAL MPCI SALES	$1,297,332.00
TOTAL MPCI COMMISSION	$154,047.28
TOTAL GROSS EXPENSE	$135,327.00
Less expenses not related to MPCI Sales & Service	-85,837.47
NET COST OF MPCI SERVICE	$49,489.59

NUMBER OF MPCI POLICIES = 165

AVERAGE COST OF SERVICING AN MPCI POLICY

49,489.59 / 165= $299.93

2004 Agency Commission Register

For FCIC Accounting Cutoff: March 11, 2005

Sherry Wegner Agency - Glasscock (481490)

Details for Sherry Wegner Agency - Glasscock (481490)

Policy	County	Crop/Plan	Comm Rate	Base Prem	Prod Prem	Fees	Int	Paymts/ Loss Cr	Total Comm	-Due- Comm	Advance
		COTTON	14.00	1,280	1,280	0	0.00	1,280.00	179.20	179.20	0.00
		COTTON	14.00	361	361	0	0.00	361.00	50.54	50.54	0.00
		COTTON	14.00	800	800	0	0.00	800.00	112.00	112.00	0.00
		COTTON	14.00	532	532	0	0.00	532.00	74.48	74.48	0.00
CROP		COTTON	14.00	231	231	0	0.00	231.00	32.34	32.34	0.00
		COTTON	14.00	851	851	0	0.00	851.00	119.14	119.14	0.00
		COTTON	15.00	360	360	0	0.00	360.00	54.00	54.00	0.00
		COTTON	15.00	702	702	0	0.00	702.00	105.30	105.30	0.00
		COTTON	15.00	720	720	0	0.00	720.00	108.00	108.00	0.00
Hail		COTTON	14.00	361	361	0	0.00	361.00	50.54	50.54	0.00
		COTTON	14.00	120	120	0	0.00	120.00	16.80	16.80	0.00
		COTTON	14.00	120	120	0	0.00	120.00	16.80	16.80	0.00
		COTTON	14.00	360	360	0	0.00	360.00	50.40	50.40	0.00
		COTTON	14.00	972	972	0	0.00	972.00	136.08	136.08	0.00
		COTTON	14.00	162	162	0	0.00	162.00	22.68	22.68	0.00
		COTTON	14.00	14,136	14,136	0	0.00	14,136.00	1,979.04	1,979.04	0.00
		COTTON	14.00	96	96	0	0.00	96.00	13.44	13.44	0.00
		COTTON	14.00	396	396	0	0.00	396.00	55.44	55.44	0.00
		COTTON	14.00	552	552	0	0.00	552.00	77.28	77.28	0.00
		COTTON	14.00	810	810	0	0.00	810.00	113.40	113.40	0.00
		COTTON	14.00	90	90	0	0.00	90.00	12.60	12.60	0.00
		WHEAT-CRC	12.00	903	370	30	0.00	400.00	108.36	108.36	0.00
MPCI		WHEAT-CRC	12.00	6,333	2,596	30	1.53	2,627.53	759.96	759.96	0.00
		WHEAT-CRC	12.00	20,421	8,372	30	0.00	8,402.00	2,450.52	2,450.52	0.00
		WHEAT-APH	14.00	340	122	30	0.00	152.00	47.60	47.60	0.00
		WHEAT-APH	14.00	1,687	607	30	0.00	637.00	236.18	236.18	0.00
		WHEAT-APH	14.00	1,552	559	30	7.36	596.36	217.28	217.28	0.00
		WHEAT-APH	14.00	91	33	30	0.00	63.00	12.74	12.74	0.00
		WHEAT-APH	14.00	291	105	30	0.29	135.29	40.74	40.74	0.00
		WHEAT-CRC	12.00	2,268	816	30	0.00	846.00	272.16	272.16	0.00
		WHEAT-APH	14.00	342	123	30	0.00	153.00	47.88	47.88	0.00
		WHEAT-APH	14.00	41	15	30	0.56	45.56	5.74	5.74	0.00
		WHEAT-CRC	12.00	1,816	745	30	0.00	775.00	217.92	217.92	0.00
		WHEAT-APH	14.00	1,509	543	30	0.00	573.00	211.26	211.26	0.00
		COTTN-CRC	12.00	8,694	2,869	30	0.00	2,899.00	1,043.28	1,043.28	0.00
		COTTN-CRC	12.00	936	309	30	0.00	339.00	112.32	112.32	0.00
		COTTN-CRC	12.00	10,757	3,550	30	0.00	3,580.00	1,290.84	1,290.84	0.00
		COTTN-CRC	12.00	2,352	776	30	20.16	826.16	282.24	282.24	0.00
		GSORG-CRC	12.00	855	283	30	11.73	324.73	102.60	102.60	0.00
		COTTN-CRC	12.00	5,319	1,915	30	24.31	1,969.31	638.28	638.28	0.00
		COTTN-CRC	12.00	20,675	7,443	30	0.00	7,473.00	2,481.00	2,481.00	0.00
		COTTN-CRC	12.00	51,274	18,459	30	52.31	18,541.31	6,152.88	6,152.88	0.00
		COTTN-CRC	12.00	6,892	2,481	30	0.00	2,511.00	827.04	827.04	0.00
		COTTN-CRC	12.00	2,373	783	30	0.00	813.00	284.76	284.76	0.00
		COTTN-CRC	12.00	1,785	642	30	0.00	672.00	214.20	214.20	0.00
		COTTN-CRC	12.00	1,785	642	30	0.00	672.00	214.20	214.20	0.00
		COTTN-CRC	12.00	2,394	790	30	30.75	850.75	287.28	287.28	0.00
		COTTN-CRC	12.00	1,677	553	30	0.00	583.00	201.24	201.24	0.00
		GSORG-CRC	12.00	545	179	30	0.00	209.00	65.40	65.40	0.00
		COTTN-CRC	12.00	4,452	1,603	30	0.00	1,633.00	534.24	534.24	0.00
		COTTN-CRC	12.00	432	143	30	0.00	173.00	51.84	51.84	0.00
		COTTN-CRC	12.00	49	16	30	0.00	46.00	5.88	5.88	0.00

Details for Sherry Wegner Agency - Glasscock (481490)

Policy	County	Crop/Plan	Comm Rate	Base Prem	Prod Prem	Fees	Int	Paymts/ Loss Cr	Total Comm	-Due- Comm	Advance
		GSORG-CRC	12.00	24	8	30	0.00	38.00	2.88	2.88	0.00
		COTTN-CRC	12.00	99	33	30	0.00	63.00	11.88	11.88	0.00
		GSORG-CRC	12.00	115	38	30	0.00	68.00	13.80	13.80	0.00
		COTTN-CRC	12.00	27,225	8,984	30	0.00	9,014.00	3,267.00	3,267.00	0.00
		COTTN-CRC	12.00	1,858	613	30	0.00	643.00	222.96	222.96	0.00
		COTTN-CRC	12.00	675	223	30	0.00	253.00	81.00	81.00	0.00
		COTTN-CRC	12.00	1,329	545	30	0.00	575.00	159.48	159.48	0.00
		COTTN-CRC	12.00	3,756	1,240	30	15.88	1,285.88	450.72	450.72	0.00
		GSORG-CRC	12.00	56	18	30	1.20	49.20	6.72	6.72	0.00
		COTTN-CRC	12.00	2,619	865	30	22.38	917.38	314.28	314.28	0.00
		GSORG-CRC	12.00	76	25	30	2.07	57.07	9.12	9.12	0.00
		COTTN-CRC	12.00	4,240	1,399	30	0.00	1,429.00	508.80	508.80	0.00
		COTTN-CRC	12.00	17,383	5,737	30	72.09	5,839.09	2,085.96	2,085.96	0.00
		GSORG-CRC	12.00	332	110	30	3.50	143.50	39.84	39.84	0.00
		COTTN-CRC	12.00	4,767	1,716	30	0.00	1,746.00	572.04	572.04	0.00
		COTTN-CRC	12.00	1,314	434	30	0.00	464.00	157.68	157.68	0.00
		COTTN-CRC	12.00	1,314	434	30	0.00	464.00	157.68	157.68	0.00
		COTTN-CRC	12.00	1,942	641	30	0.00	671.00	233.04	233.04	0.00
		COTTN-CRC	12.00	9,267	3,336	30	0.00	3,366.00	1,112.04	1,112.04	0.00
		COTTN-CRC	12.00	199	66	30	0.00	96.00	23.88	23.88	0.00
		GSORG-CRC	12.00	93	31	30	0.00	61.00	11.16	11.16	0.00
		COTTN-CRC	12.00	2,806	1,010	30	0.00	1,040.00	336.72	336.72	0.00
		COTTN-CRC	12.00	1,269	419	30	0.00	449.00	152.28	152.28	0.00
		COTTN-CRC	12.00	702	232	30	0.00	262.00	84.24	84.24	0.00
		COTTN-CRC	12.00	17,018	6,126	30	76.95	6,232.95	2,042.16	2,042.16	0.00
		COTTN-CRC	12.00	3,057	1,100	30	28.26	1,158.26	366.84	366.84	0.00
		COTTN-CRC	12.00	10,310	3,712	30	93.56	3,835.56	1,237.20	1,237.20	0.00
		COTTN-CRC	12.00	2,195	790	30	20.50	840.50	263.40	263.40	0.00
		COTTN-CRC	12.00	3,166	1,045	30	0.00	1,075.00	379.92	379.92	0.00
		COTTN-CRC	12.00	52,134	17,203	30	0.00	17,233.00	6,256.08	6,256.08	0.00
		COTTN-CRC	12.00	16,651	5,495	30	0.00	5,525.00	1,998.12	1,998.12	0.00
		COTTN-APH	5.00	4,514	0	100	3.75	103.75	225.70	225.70	0.00
		COTTN-CRC	12.00	24,143	7,968	30	0.00	7,998.00	2,897.16	2,897.16	0.00
		GSORG-CRC	12.00	518	171	30	0.00	201.00	62.16	62.16	0.00
		COTTN-APH	5.00	511	0	100	0.00	100.00	25.55	25.55	0.00
		GSORG-CRC	12.00	86	28	30	0.00	58.00	10.32	10.32	0.00
		COTTN-CRC	12.00	14,813	5,333	30	0.00	5,363.00	1,777.56	1,777.56	0.00
		COTTN-CRC	12.00	21,648	7,793	30	0.00	7,823.00	2,597.76	2,597.76	0.00
		COTTN-CRC	12.00	107	35	30	0.00	65.00	12.84	12.84	0.00
		COTTN-CRC	12.00	3,392	1,221	30	0.00	1,251.00	407.04	407.04	0.00
		COTTN-CRC	12.00	6,129	2,206	30	0.00	2,236.00	735.48	735.48	0.00
		COTTN-CRC	12.00	13,433	4,836	30	0.00	4,866.00	1,611.96	1,611.96	0.00
		COTTN-CRC	12.00	1,404	463	30	6.16	499.16	168.48	168.48	0.00
		GSORG-CRC	12.00	69	23	30	1.32	54.32	8.28	8.28	0.00
		COTTN-CRC	12.00	7,061	2,330	30	0.00	2,360.00	847.32	847.32	0.00
		COTTN-CRC	12.00	468	155	30	2.31	187.31	56.16	56.16	0.00
		GSORG-CRC	12.00	23	8	30	0.96	38.96	2.76	2.76	0.00
		COTTN-CRC	12.00	44,548	14,700	30	0.00	14,730.00	5,345.76	5,345.76	0.00
		GSORG-CRC	12.00	189	62	30	0.00	92.00	22.68	22.68	0.00
		COTTN-APH	5.00	8,475	0	100	0.00	100.00	423.75	423.75	0.00
		GSORG-APH	5.00	37	0	100	0.00	100.00	1.85	1.85	0.00
		COTTN-CRC	12.00	407	134	30	0.00	164.00	48.84	48.84	0.00

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2004 Agency Commission Register

For FCIC Accounting Cutoff: March 11, 2005

Sherry Wegner Agency - Glasscock (481490)

Details for Sherry Wegner Agency - Glasscock (481490)

Policy	County	Crop/Plan	Comm Rate	Base Prem	Prod Prem	Fees	Int	Paymts/ Loss Cr	Total Comm	-Due- Comm	Advance
		COTTN-CRC	12.00	407	134	30	0.00	164.00	48.84	48.84	0.00
		COTTN-CRC	12.00	435	156	30	0.00	186.00	52.20	52.20	0.00
		COTTN-CRC	12.00	3,193	1,149	30	0.00	1,179.00	383.16	383.16	0.00
		COTTN-CRC	12.00	435	156	30	4.66	190.66	52.20	52.20	0.00
		COTTN-CRC	12.00	58,566	21,084	30	0.00	21,114.00	7,027.92	7,027.92	0.00
		COTTN-CRC	12.00	14,093	4,652	30	0.00	4,682.00	1,691.16	1,691.16	0.00
		COTTN-CRC	12.00	14,354	4,738	30	0.00	4,768.00	1,722.48	1,722.48	0.00
		COTTN-CRC	12.00	3,261	1,174	30	0.00	1,204.00	391.32	391.32	0.00
		COTTN-CRC	12.00	8,301	2,739	30	138.44	2,907.44	996.12	996.12	0.00
		COTTN-CRC	12.00	761	274	30	0.00	304.00	91.32	91.32	0.00
		COTTN-CRC	12.00	36,393	12,009	30	0.00	12,039.00	4,367.16	4,367.16	0.00
		COTTN-CRC	12.00	1,210	399	30	0.00	429.00	145.20	145.20	0.00
		COTTN-CRC	12.00	435	156	30	0.00	186.00	52.20	52.20	0.00
		COTTN-APH	5.00	16,677	0	100	0.00	100.00	833.85	833.85	0.00
		COTTN-CRC	12.00	72,558	29,749	30	0.00	29,779.00	8,706.96	8,706.96	0.00
		COTTN-CRC	12.00	2,902	958	30	0.00	988.00	348.24	348.24	0.00
		COTTN-CRC	12.00	2,861	944	30	0.00	974.00	343.32	343.32	0.00
		COTTN-CRC	12.00	2,727	900	30	0.00	930.00	327.24	327.24	0.00
		COTTN-CRC	12.00	23,957	7,906	30	0.00	7,936.00	2,874.84	2,874.84	0.00
		COTTN-CRC	12.00	7,905	2,608	30	0.00	2,638.00	948.60	948.60	0.00
		COTTN-CRC	12.00	34,330	11,329	30	0.00	11,359.00	4,119.60	4,119.60	0.00
		COTTN-CRC	12.00	37	12	30	0.00	42.00	4.44	4.44	0.00
		COTTN-CRC	12.00	4,683	1,920	30	0.00	1,950.00	561.96	561.96	0.00
		GSORG-CRC	12.00	144	52	30	0.00	82.00	17.28	17.28	0.00
		COTTN-CRC	12.00	41,805	17,138	30	214.60	17,382.60	5,016.60	5,016.60	0.00
		COTTN-CRC	12.00	64	26	30	0.00	56.00	7.68	7.68	0.00
		COTTN-CRC	12.00	37	12	30	0.00	42.00	4.44	4.44	0.00
		COTTN-CRC	12.00	7,725	2,549	30	0.00	2,579.00	927.00	927.00	0.00
		COTTN-CRC	12.00	37	12	30	0.00	42.00	4.44	4.44	0.00
		COTTN-CRC	12.00	1,693	559	30	0.00	589.00	203.16	203.16	0.00
		GSORG-CRC	12.00	114	38	30	0.00	68.00	13.68	13.68	0.00
		COTTN-APH	5.00	1,525	0	100	0.00	100.00	76.25	76.25	0.00
		COTTN-APH	5.00	2,107	0	100	0.00	100.00	105.35	105.35	0.00
		COTTN-CRC	12.00	28,048	9,255	30	232.12	9,517.12	3,365.76	3,365.76	0.00
		GSORG-CRC	12.00	642	212	30	9.09	251.09	77.04	77.04	0.00
		COTTN-CRC	12.00	28,686	9,467	30	0.00	9,497.00	3,442.32	3,442.32	0.00
		COTTN-CRC	12.00	1,723	620	30	17.43	667.43	206.76	206.76	0.00
		COTTN-CRC	12.00	11,509	3,797	30	0.00	3,827.00	1,381.08	1,381.08	0.00
		COTTN-CRC	12.00	5,617	1,853	30	0.00	1,883.00	674.04	674.04	0.00
		GSORG-CRC	12.00	63	21	30	0.00	51.00	7.56	7.56	0.00
		COTTN-CRC	12.00	3,011	994	30	0.00	1,024.00	361.32	361.32	0.00
		COTTN-CRC	12.00	2,000	720	30	0.00	750.00	240.00	240.00	0.00
		COTTN-APH	5.00	4,883	0	100	0.00	100.00	244.15	244.15	0.00
		COTTN-CRC	12.00	35,229	12,682	30	0.00	12,712.00	4,227.48	4,227.48	0.00
		COTTN-CRC	12.00	68,182	27,955	30	0.00	27,985.00	8,181.84	8,181.84	0.00
		WHEAT-APH	14.00	4	2	30	0.00	32.00	0.56	0.56	0.00
		WHEAT-APH	14.00	4	2	30	0.00	32.00	0.56	0.56	0.00
		WHEAT-APH	14.00	754	272	30	0.00	302.00	105.56	105.56	0.00
		WHEAT-APH	14.00	45	16	30	0.00	46.00	6.30	6.30	0.00
		WHEAT-CRC	12.00	52	21	30	0.00	51.00	6.24	6.24	0.00
		WHEAT-APH	14.00	3,521	1,268	30	0.00	1,298.00	492.94	492.94	0.00
		WHEAT-APH	14.00	224	81	30	0.00	111.00	31.36	31.36	0.00

2004 Agency Commission Register

For FCIC Accounting Cutoff: March 11, 2005

Sherry Wegner Agency - Glasscock (481490)

Details for Sherry Wegner Agency - Glasscock (481490)

Policy	County	Crop/Plan	Comm Rate	Base Prem	Prod Prem	Fees	Int	Paymts/ Loss Cr	Total Comm	-Due- Comm	Advance
		WHEAT-CRC	12.00	794	326	30	0.00	356.00	95.28	95.28	0.00
		WHEAT-CRC	12.00	850	306	30	0.00	336.00	102.00	102.00	0.00
		WHEAT-APH	14.00	224	81	30	0.00	111.00	31.36	31.36	0.00
		WHEAT-APH	14.00	4	2	30	0.00	32.00	0.56	0.56	0.00
		WHEAT-APH	14.00	224	81	30	0.00	111.00	31.36	31.36	0.00
		WHEAT-APH	14.00	2,484	894	30	0.00	924.00	347.76	347.76	0.00
		WHEAT-APH	14.00	8,373	3,014	30	0.00	3,044.00	1,172.22	1,172.22	0.00
		WHEAT-APH	14.00	16,403	5,905	30	0.00	5,935.00	2,296.42	2,296.42	0.00
		WHEAT-APH	14.00	177	64	30	0.00	94.00	24.78	24.78	0.00
		WHEAT-APH	14.00	2,278	934	30	0.00	964.00	318.92	318.92	0.00
		WHEAT-APH	14.00	171	62	30	0.00	92.00	23.94	23.94	0.00
		WHEAT-APH	14.00	328	135	30	0.00	165.00	45.92	45.92	0.00
		WHEAT-APH	14.00	1,699	561	30	0.00	591.00	237.86	237.86	0.00
		WHEAT-APH	14.00	4,410	1,808	30	0.00	1,838.00	617.40	617.40	0.00
		WHEAT-CRC	12.00	2,381	977	30	0.00	1,007.00	285.72	285.72	0.00
		WHEAT-APH	14.00	8,084	3,314	30	4.51	3,348.51	1,131.76	1,131.76	0.00
		WHEAT-APH	14.00	28	10	30	0.00	40.00	3.92	3.92	0.00
		WHEAT-APH	14.00	34	12	30	0.00	42.00	4.76	4.76	0.00
		WHEAT-APH	14.00	61	20	30	0.00	50.00	8.54	8.54	0.00
		WHEAT-APH	14.00	508	167	30	0.00	197.00	71.12	71.12	0.00
		COTTN-CRC	12.00	7,405	2,444	30	61.86	2,535.86	888.60	888.60	0.00
		COTTN-CRC	12.00	8,411	2,776	30	70.16	2,876.16	1,009.32	1,009.32	0.00
		COTTN-CRC	12.00	57	19	30	0.00	49.00	6.84	6.84	0.00
		GSORG-CRC	12.00	18	6	30	0.00	36.00	2.16	2.16	0.00
		COTTN-APH	5.00	559	0	100	0.00	100.00	27.95	27.95	0.00
		COTTN-CRC	12.00	8,760	3,592	30	90.56	3,712.56	1,051.20	1,051.20	0.00
		COTTN-CRC	12.00	144,997	52,198	30	0.00	52,228.00	17,399.64	17,399.64	0.00
		COTTN-CRC	12.00	7,235	2,605	30	0.00	2,635.00	868.20	868.20	0.00
		COTTN-CRC	12.00	7,235	2,605	30	0.00	2,635.00	868.20	868.20	0.00
		COTTN-CRC	12.00	2,405	865	30	0.00	895.00	288.60	288.60	0.00
			REV:	1,202,149	429,277	3,750	1,326.85	434,353.85	144,257.88	144,257.88	0.00
			MPCI:	55,895	20,812	930	12.72	21,754.72	7,825.30	7,825.30	0.00
			CAT:	39,288	0	900	3.75	903.75	1,964.40	1,964.40	0.00

Appendix C

Examples of RMA's Regulatory Excess

Additional Paperwork and Regulatory Burdens Are Making the Program More Difficult and Expensive to Deliver

Problem definition: To implement the Federal Crop Insurance Act – which includes provisions intending to help control, reduce and eliminate fraud, waste, and abuse in and of the crop insurance program – RMA, working with the authority granted by the FCIC, has developed and finalized certain critical changes to the Basic Provisions for the 2005 crop insurance year. In addition, RMA made other regulatory changes in the new Standard Reinsurance Agreement (SRA) that was adopted in 2004.

While no one condones fraud, waste, and abuse, some of the regulations adopted by RMA are excessively rigid and can result in punitive damages. **For example, some of the changes do not adequately allow for or accommodate common, unintended mistakes and errors of data entry by either farmers or agents and companies, even when there is no adverse pattern of practice.** Nonetheless, under the new provisions, these everyday innocent clerical mistakes would result in substantial penalties at claim filing. The implementation and administration of these regulations, especially after the changes made in 2004, are reaching the point of being overly burdensome and wasteful. Industry resources, both human and capital, are already stressed as a result of the increasing complexity of the insurance program of crop and livestock enterprise risk management. Additionally, the changes establish a discriminatory relationship between USDA agencies regarding the treatment of farmers. For example, reporting errors in the Farm Service Agency (FSA) records, when discovered, are simply corrected. However, reporting errors in RMA records are not correctable in some instances and penalties can be assessed. This development is occurring in spite of the fact that ARPA called for greater cooperation and reporting and record consistency between the two agencies.

Problem impact: As a result of these regulations, farmers can lose significant amounts of insurance coverage even when there is no intent to commit fraud, waste or abuse. This will cause immediate financial harm and there will be a reduction in confidence in and acceptance of the risk management program by farmers and their lenders.

Farmers have more and more crop insurance options; farmer use of insurance for risk management has grown, often with the encouragement or insistence of lenders, who have advocated insurance coverage as a form of loan protection. An uncertain financial situation results if planned coverage does not materialize when needed because of extreme penalties resulting from inadvertent and unintentional errors on the insurance policy. Loan collateral will have changed which changes the relative position of lenders; this creates a very uncertain financial situation.

In the meantime, valuable industry resources in terms of both time and money will be consumed, some would say wasted, implementing excessive, burdensome and cumbersome regulations that are, in many respects, draconian in nature or simply silly. At the very least, these regulatory changes to the Basic Provisions are likely to constrain further expansion of the program as a risk management tool, if not serve to actually reduce the incidence of its use. It is a concern that these problematic changes have been made in spite of an overwhelming number of industry comments describing the potential negative impact and related shortcomings.

<u>Problem examples:</u> The following examples are presented to illustrate how key changes made by RMA will impact insured farmers. The concerns arise from the inability, as set forth in regulation, for either the insured (farmers) or the agent and company to correct a policy record at the time of the discovery of an error, whenever that occurs, in order to keep the coverage in effect, as originally contracted, to provide the risk protection as originally planned. A complicating factor is that in certain instances RMA uses earlier reporting dates than does FSA.

<u>1. Entity Reporting Requirement</u>—the recording of a farm name and farm ownership structure (individual, partnership, or corporation).

RMA Rule: An error in reporting an entity's ownership type or tax identification number will result in reduction of A&O reimbursement if not corrected by the sales closing date and voidance of the policy if not corrected by the acreage reporting date.

Concern: A reduction in the A&O reimbursement for misreporting the entity type or tax identification number that is corrected more than 30 days after the sales closing date but prior to the acreage reporting date would result in penalizing the insurance provider and the agent – even if the error was made by the insured. This is treating the insurance provider and ultimately the insurance agent unfairly for incorrect information that is beyond their control.

RMA Rule: A policy shall be voided if the entity type or tax identification number is discovered to be incorrect after the acreage reporting date.

Potential effect of the penalty for errors in reporting tax identification numbers:

> Example 1: Applicant is in the insurance agent's office and realizes that he does not have his wife's Social Security number with him. He calls home and she gives it to him over the phone. He writes it down on the Substantial Beneficial Interest (SBI) reporting form and transposes two numbers. His wife does not notice that the 1 and the 7 are reversed when she reviews the policy paperwork. They have a loss on the policy and it would be voided because her tax identification number contained a simple and explainable error.

While there is an opportunity to correct an "obvious" transposition of numbers, the definition of obvious is not known nor is it known who makes this decision. In all likelihood, the transposition of digits that make up a social security number will not be identified as an obvious error for a very obvious reason—the correct order will simply not be known thus a visual inspection can not detect an incorrect ordering.

There is also no allowance for a data entry error, such as mistaking a “3” for an “8”, if it is not corrected by the Acreage Reporting Date.

> Example 2: Robert has the Power of Attorney to do crop insurance business for his aunt who is in a nursing home. Six years ago he applied for crop insurance for his aunt and provided her Social Security number as required. The number has been masked on nearly all paperwork for privacy reasons. In 2005, there is a loss for the first time on the aunt’s policy. It is discovered at loss time that the Social Security number for the aunt was entered wrong by the insurance company and went unnoticed by Robert. There is no coverage in place because the policy is considered void as a result of an error in the TIN.

Concern: Voiding a policy is far too severe a penalty unless the misreporting was intentional and part of a pattern of practice.

It would seem more reasonable to identify intention for the purposes of assigning penalties by determining whether there is a potential gain due to the misreporting of information.

Losing insurance coverage due to an innocent reporting error may result in a farmer being unable to stay in business. This result will create a public relations problem for crop insurance and FCIC, and it would certainly weaken the safety net the crop insurance program provides for our agricultural economy. The seemingly arbitrary penalties could cause lenders to rethink their current increasing use of crop insurance as collateral. Also, this experience will increase agent’s E&O exposure.

2. Substantial Beneficial Interest (SBI) Reporting Requirement—recording of persons who have a 10 percent or greater interest in the insured entity.

RMA Rule: Not reporting a person who is an SBI of an insured entity will result in one of two penalties depending on the status of that person.

First, failing to report a person who is an SBI and **eligible** for crop insurance under the Act will result in the insurable interest for the entity being reduced by the share of the unreported person.

Beginning in 2005, each person with an SBI, due to direct or indirect ownership, must be reported. For example, assume XYZ Corporation is an insured entity and reports 100 percent interest in the insured crop. Further, assume XYZ Corporation is 50 percent owned by Partnership A and 50 percent owned by Partnership B. Partnership A is owned 50 percent each by Adam and Fred. Partnership B is owned 50 percent each by Bob and Mary. Under the 2005 Basic Provisions, both partnerships (A&B) and all four of the individuals (Adam, Fred, Bob and Mary) who own the partnerships must be listed in the SBI. In this example, each of the four individuals own a 25 percent indirect interest in XYZ Corporation, therefore all four are said to be an SBI. The new RMA rule says that if an SBI is not reported, the insured share of the entity (XYZ Corp) must be reduced by the amount of the share of the unreported SBI. Thus, failing to report Adam, Fred, Bob and Mary, even though the two partnerships A and B are reported, would result in a 100 percent reduction – the total of the unreported indirect shares of Adam, Fred, Bob and Mary. In this example, XYZ Corporation would have zero insurance coverage.

It is not reasonable to reduce coverage to zero if it can be established that there was no potential gain for any of the parties based on the failure to report the entities within the entity.

Second, failing to report a person who is an SBI and **ineligible** for crop insurance under the Act will result in voidance of the policy for the corporation no matter how many SBIs there are or how many of them are eligible for crop insurance.

Concern: This rule will be easily misunderstood by farmers, creating a substantial number of opportunities for errors that will result in significant penalties and negative public opinion. Unintentional omissions of entities reduce or void the coverage.

3. Excessive Yields Reporting Requirement—the reporting of actual yields either two and one-half times or four times greater than the "T" yield.

RMA Rule: Any actual yield that is considered to be an excessive yield, as defined by the procedure, must be submitted to RMA for approval before it can be reported as the effective yield for that year.

If the RMA reviewer determines the records provided as proof of the yield by the insured are unacceptable, the approved yield will be removed and all the actual yields reported for that crop and county that year will be removed and replaced with an assigned yield. In addition, all optional units will be combined into basic units.

However, if the records are acceptable but the RMA reviewer determines the insured did not provide adequate evidence or proof as to why the unit produced a yield much higher than other units on the policy or surrounding farms, the high yield may be denied. In this event, the excessive yield is removed and replaced with a simple average of the APH yield from the other units of the crop on the policy.

Concern: It is very difficult for an RMA reviewer to be knowledgeable enough about growing conditions and farming practices throughout the United States to arrive at an informed conclusion as to the acceptability and reasonableness of actual production records.

Insurance providers in the area would be a much better source of review and recommendation as to the unit's ability to have produced the yield in a given year and area. Furthermore, the process as it is today seems to conflict with the spirit of the APH procedure which is designed to cover each individual insured, by unit, based on his or her actual yields. The current process unfortunately penalizes insureds that are carrying out new or improved cultural practices simply because the reviewers do not know if the unit actually produced the reported yield.

4. Inconsistent Yields

The 2005 Basic Provisions define an inconsistent yield as an APH that is 115 percent greater than the simple average of the other APH yields from all other units of the same crop (same practice, type, variety and map area) in the same county. If a database has an inconsistent APH and either the acreage planted exceeds 400 percent of the simple average of acres reported on the APH database or the acreage in the APH database includes two or more years in which the acreage in the APH database is less than 10 percent of the current years planted acreage, the inconsistent APH will be replaced for the current crop year for purposes of establishing the guarantee and premium rate. To replace the APH yield, a simple average of all other APH yields from the county/crop of the same P/T/V/TMAP will be used in its place.

Concern: The problem with this rule is that yield verifiers for the insurance provider will not know if acreage tolerances are triggered until after the acres are reported for the current year. Typically the APH yield is updated and an Approved APH Yield is issued to the insured prior to the acreage being reported and usually prior to planting. Once the Approved APH Yield is known, the per acre guarantee and the coverage per acre can be calculated. Farmers make marketing decisions based on their expected insurance protection. Also, many agricultural lenders use this information to determine the amount of collateral the crop insurance policy represents for lending purposes. This provision, although seemingly targeted at program abuse, could result in more bad public relations with farmers and farm lenders.

5. Indemnity Reduction Factor

RMA Rule: The indemnity reduction factor will be used to reduce an indemnity on a unit if information provided by the insured is found to be incorrect and, when corrected, the liability changes by more than 10 percent. The indemnity payable on the unit, if any, will be reduced by the amount of change in excess of 10 percent.

Potential effect of the penalty for misreporting liability by more than 10 percent [Basic Provisions for MPCI 6. (g)(2)]:

> Example 1: Producer had 100 percent interest in the crop in section 1 in 2004. In 2005 he decides to have his two grandsons farm section 1 for him for a share of the crop. Each grandson insures the crop on his own policy showing a 33.3 percent interest. On the acreage report, the grandfather reports his acres but he overlooks adjusting his percent of share down to 33.3 percent. Because he has over-reported by 200 percent and there is only a 10 percent tolerance for misreporting liability, the grandfather's penalty in the event of a loss is that he gets nothing. The calculations result in a 190 percent reduction to his loss payment. Under the previous rules the grandfather's share would have been

reduced to his actual share when a loss was calculated. The grandfather has nothing to gain by over-reporting his share – in fact, if there is no loss and it goes unnoticed, he would overpay premium.

Example 2: Producer had 50 percent share in the crop last year as a share rent arrangement. In 2005 she is cash renting the ground from the landlord and will have 100 percent interest in the crop. She reports the acres on her acreage report but overlooks increasing her percent of share from 50 percent to 100 percent. In the past, if there was a loss she would be paid for only 50 percent of her share (the lesser of what was reported or what her actual interest was). In the case of a loss in 2005, she would be paid only 60 percent of the indemnity for the 50 percent reported share. She has reported half her actual liability, which is a misreporting of 50 percent. She is 40 percent over the 10 percent tolerance; so her indemnity (which is calculated at the 50 percent share she reported, not her actual 100 percent interest) would be further reduced by 40 percent as a penalty for her error. If her loss at 100 percent was $25,000, her indemnity would first be reduced to $12,500 because she only reported her share to be 50 percent. (This seems fair because she would only have paid 50 percent of the premium if she had not had a loss.) However, under the 2005 provisions she also would have a further reduction of 40 percent bringing her indemnity down to $7,500. This happens because she forgot to adjust her percent of share on her acreage report from 50 percent to 100 percent.

Concern: Most reporting errors are discovered at the time of a loss and in most instances the error cannot be corrected due to damage having already occurred to the crop; as a result the liability cannot be increased.

In these instances, insureds were already being penalized under previous rules because they were not eligible for an indemnity on the under-reported liability and any production to count from under-reported or unreported acreage was also used as production to count against the reported acreage.

The indemnity reduction factor required by 2005 rules that is to be applied on top of this will likely result in the insured feeling the policy and procedures are too harsh. Insureds will be upset with the way companies pay claims and could decide that the policy structure is undependable – thus not really managing their risk.

Over-reporting of interest share or insured acres have never been in the best interest of the insured. If there is a claim, the interest and acres are reduced to what is determined to be correct during the loss adjustment. If there is not a claim, the insured overpays premium. There were already checks and balances for both under- and over-reporting

<u>The 2005 Basic Provisions will now apply an indemnity reduction factor if the corrected liability is changed by more than 10 percent and this will result in a double penalty for the insured.</u>

Misreporting crop share is a common reporting error. As land is purchased or cash rented, forgetting to adjust percent of share on a unit could easily result in a 100 percent or 200 percent reporting error. Rarely will crop share reporting errors be within the 10 percent tolerance. This would virtually void coverage on the unit. It is unlikely that there would be an intentional misreporting of percent of share to gain some sort of advantage that would represent fraud, waste, or abuse.

6. High Dollar Claims

RMA Rule: In Appendix IV of the SRA, it is proposed that any claim over $100,000 be subject to an automatic review of the APH yield records for the most recent three crop years.

Concern: This is a provision that will have a serious impact on adjusters, agents and policyholders. At the time of a claim, this provision will be a time consuming ordeal for adjusters and insureds. Many claims will be delayed for months to comply with this provision. It is discriminatory to high value crops and to certain areas of the country. Many specialty crops as well as cotton and rice would be greatly affected. It will also discriminate against large farming operations and delay their legitimate indemnity payments. Previous requirements for compliance reviews already addressed high dollar losses.

RMA Rule: RMA has the discretion to act as loss adjuster on high dollar claims.

Concern: This change has caused companies to delay action on claims that could exceed the high dollar threshold until it is known whether RMA intends to conduct loss adjustment review. The net result is that service to the farmer is delayed.

A high dollar claim by its very nature is a sophisticated undertaking. Traditionally these claims are worked by the most experienced members of a company's adjustment staff. Since RMA personnel have not been involved in loss adjustment for many years, there is every reason to expect that their work will be less efficient than company adjusters. Furthermore, it duplicates a service already provided by the companies. At a time when RMA is concerned with its own budget problems, it does not seem prudent for the agency to be taking on additional tasks which are already performed by the industry in a satisfactory manner. Companies have every incentive to work high dollar claims with the greatest of care – they have dollars at stake.

7. Arbitration

RMA Rule: Any ruling by arbitration can be reversed should RMA determine there is a policy conflict.

Concern: In most cases the Basic Provisions require a farmer who disagrees with the settlement of a claim to submit the disagreement to binding arbitration. Now, if an arbitration ruling is made in favor of a farmer and if that ruling involves procedural issues, RMA will have the ability to overrule the arbitrator if there was a failure to obtain a policy interpretation from RMA. This rule creates a highly inconsistent policy and could result in a loss of faith in the program.

8. Prevented Planted Acres

RMA Rule: Once submitted to RMA, no prevented planted acres can be changed, even if proposed before the final acreage reporting date. Prevented planting policy rules are very complex; to allow zero tolerance for corrections WITHIN the acreage reporting period is extremely restrictive.

9. Acreage Report Revision

RMA Rule: Beginning with the 2005 crop year, acreage reports can no longer be revised after the acreage reporting date.

Concern: This is a problem for perennial crops, especially. Growers both buy and sell groves throughout the year, and corresponding additions and reductions to their policies must be allowable in this circumstance. Also, the ability to make revisions is necessary in the case of an honest mistake in entering the data or filling out the forms. Often these errors are not spotted until much later, when the Summary of Coverage for the policy is printed. Any revision made currently requires an inspection by the company verifying both the correctness of the revision and that no loss has occurred to the crop up to that point and prior to the revision taking place, therefore, the potential for fraud is removed. Preventing these types of changes denies growers the protection promised by Congress when the program was enacted.

Potential effect of the penalty for misreporting acreage:

> Producer reports a 116 acre field of soybeans in section 6. He forgets to include 25 acres in another tract in the same section where he intended to plant corn, but ended up planting soybeans. When he has a loss on the unit, the production for all 141 acres is counted, but the number of bushels he is guaranteed is determined by the 116 he reported; this effectively penalizes him for under-reporting the number of acres on the unit.
>
> For 2005 he has an additional penalty because he under-reported by more than the 10 percent tolerance. He has under-reported by 17.7 percent, which is 7.7 percent more than the tolerance, so his calculated indemnity would be reduced by 7.7 percent

10. Conflict of Interest

RMA Rule: RMA has submitted a very confusing and vague set of regulations of what constitutes a conflict of interest. **For example, if a certain company sells crop insurance as well as other insurance products or lends money to a given farmer,**

according to RMA, that is not considered to be a potential conflict of interest. However, if a certain company sells crop insurance as well as seed products to a given farmer, according to RMA, that is considered a potential conflict of interest.

Concern: The uncertainty about implementation and consequences of this rule are causing companies and agencies to make drastic and unfortunate choices regarding participation in the delivery of crop insurance.

<u>Problem conclusion:</u> These concerns about recent regulatory changes have been presented to RMA and are being presented today to ask for your assistance in having RMA modify their rules and procedures regarding the handling of misreported information and to make other necessary clarifications. Congress, RMA, approved crop insurance companies and crop insurance agents have all worked very hard to increase participation and public confidence in the crop insurance program. The regulatory changes included in this presentation are likely to result in a setback due to the harsh treatment of common reporting errors made by farmers who reported the information in a good-faith manner and will be offended by the treatment afforded them under the new policy and procedures. Without immediate changes to these provisions, most likely there will be an increase in complaints to the U.S. Department Agriculture, the Congress and state departments of insurance across the country. Furthermore, the uncertain financial climate created by these provisions can inflict considerable harm on the growing reputation of the federal crop insurance program as an effective stabilizing force for farm and rural economies. Finally, these provisions very definitely will increase E&O exposure and increase it dramatically.

Appendix D

HISTORIC RATE OF RETURN ANALYSIS

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November 11, 2002

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Executive Summary

The Risk Management Agency (RMA) of the U.S. Department of Agriculture (USDA) engaged Milliman USA (Milliman) to recommend and implement a methodology, based on insurance industry standards, to calculate the historical rate of return attributable to the sale of multiple peril crop insurance reinsured through the Standard Reinsurance Agreement (SRA). This engagement requires Milliman to estimate the actual rate of return for multiple peril crop insurance (MPCI) for the reinsurance years 1989 through 2001 at the aggregate level, as well the returns for individual providers, funds, and years, with and without the impact of catastrophe coverage.

The rate of return on equity is the metric that is generally used to evaluate the profitability of investment opportunities. Similarly, in a regulatory context, rate of return on equity is typically used as the target return that a regulated entity should be permitted when setting the price for the regulated good or service. For both purposes, the proper rate of return is understood to be the economic rate of return on equity capital.

As with many economic or actuarial analyses, the estimation of the actual rate of return has to balance the objective of precision in results with practical concerns about both data availability and the costs of implementation. Fortunately, in calculating the historical rate of return attributable to property casualty insurance, there is fairly widespread agreement as regards the proper methodology for measurement. The current standard in the property casualty insurance industry relies on a methodology that decomposes the total rate of return into three components: underwriting profit, investment income on insurance operations, and investment income on the insurer's equity capital (or surplus). This methodology is consistent with statutory accounting standards promulgated by the National Association of Insurance Commissioners (NAIC) (as exemplified by the financial reporting contained in the insurance annual statement), as well as insurance industry sources and publications (such as the reports published by A.M Best Co.).

In light of the work order for this engagement, we believe the standard methodology (decomposing returns into underwriting profit, investment income on insurance operations, and investment income on the insurer's equity) is appropriate for calculating the historical returns attributable to multiple peril crop insurance. However, the somewhat unusual nature of MPCI requires that the methodology be adapted, so as to produce results that are consistent with other lines of insurance. This is particularly important when considering the potential profitability attributable to the expense reimbursement provided under the SRA, as well as when allocating equity across lines of insurance. We discuss these issues at length in the attached report.

Our report also provides estimates of returns attributable to multi peril crop insurance for individual insurance providers. We emphasize that these estimates are based on standardized assumptions, applied to all insurance providers, regarding the amount of equity supporting the insurance transaction and the investment rate of return. Because actual levels of capitalization and investment portfolios differ across insurers, the returns estimated here will differ from the returns reported by individual insurance providers. However, we believe it is appropriate to rely on industrywide standard assumptions for these variables, since the estimated historical rate of return is ultimately compared to an industry average cost of capital. In order to be consistent with an industry average cost of capital, it is reasonable to assume an industry average level of capitalization and investment portfolio.

Turning to a very brief summary of the most important results, we present below a table showing the actual returns earned by MPCI insurers for the years 1989 – 2001, across all plans of insurance and funds, with and without the impact of the catastrophic risk protection plan of insurance. (Since the information needed to separate catastrophe coverage from other plans of insurance is only available for four years, and the coverage itself has only been in existence since 1995, we don't address the results further in this summary.)

Table 1. Actual Versus Reasonable Rate of Return by Reinsurance Year
All Insurers, Funds and Plans Combined

Year	Average	Average Excl Cat. Coverage	Reasonable Rate of Return
1989	16.8%	.	14.8%
1990	21.2%	.	15.9%
1991	16.6%	.	16.2%
1992	12.5%	.	15.4%
1993	(15.6%)	.	14.5%
1994	25.8%	.	13.4%
1995	21.3%	.	13.7%
1996	22.2%	.	13.4%
1997	25.0%	.	13.2%
1998	16.6%	14.8%	12.7%
1999	13.9%	11.8%	12.9%
2000	14.2%	12.6%	12.7%
2001	15.5%	14.0%	13.1%
Average	15.8%	13.3%	14.0%
Std. Deviation	10.4%	1.4%	1.2%

As can be seen from the table above, the estimated earned return on equity for MPCI insurers has averaged approximately 15.8%, as compared with an average reasonable rate of return over the same period of 14.0%. Thus, while MPCI insurers have earned a return somewhat in excess of the cost of capital, the returns are somewhat volatile as well, as evidenced by the fact that in the single catastrophe year, the overall rate of return was –15.6%. In fact, we would caution against drawing any strong conclusions on the adequacy or excessiveness of the historical returns based on a sample of thirteen years of data, in light of the fact that only one of those years is a catastrophe year. Had there been a second catastrophe year in the sample similar in magnitude to 1993, the average return over the period would have been below 14%.

The remainder of this report describes the methodology, calculations and results of our analysis.

1. Background

Crop production can be a risky business, vulnerable to frequent disruption from adverse weather, pests and diseases. Historically, federal disaster assistance had been the main safety net for producers, but in more recent years, multiple peril crop insurance has gradually assumed the central role in crop production risk management. The level of coverage, the range of crops insured, and the type of insurance policies have all been expanded since the enactment of the Federal Crop Insurance Act of 1980. As a result, the budget of the Federal crop insurance program has expanded from under $77.8 million in 1981 to $3.2 billion in 2001.[1] Under the current program, the Federal government subsidizes producers (farmers) through both a premium subsidy, an administrative and operation (A&O) subsidy and free reinsurance to the insurance providers through the Standard Reinsurance Agreement (SRA).

By using private insurers to deliver and service crop insurance contracts, the program can rely on market forces to ensure the efficient production of insurance services. However, to assure adequate capacity in the program, the pricing of insurance contracts (or in this case the structure of the SRA and the level of the A&O subsidy) must offer investors reasonable compensation for bearing the risks associated with underwriting crop insurance. In addition, to monitor whether the program meets or has met its objectives regarding fair compensation to insurers, it is necessary to measure and evaluate the actual returns insurers have earned.

In a separate study, Milliman established the methodology and estimated the reasonable rate of return for multiple peril crop insurance (Appel et al, 2002). In this study, we establish the methodology to measure the historical return earned by multiple peril crop insurers, and, based on that methodology, estimate the rate of return to the insurance providers' equity for years 1989 through 2001.

2. Methodology

The rate of return on equity is generally used to evaluate the profitability of investment opportunities. Similarly, when setting the price for the good or service in a regulatory context, rate of return on equity is typically used as the target return that the regulated entity should be permitted. For both purposes, the proper rate of return is understood to be the economic rate of return on equity capital.[2]

As with many economic or actuarial analyses, the estimation of the actual rate of return has to balance the objective of precision in results with practical concerns about both data availability and

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[1] For more detailed discussion of the history of the Federal crop insurance program, see Glauber and Collins (2002).

[2] In theory, the economic rate of return should be measured based on the market value of equity, however in practice, because of the highly volatile nature of market values, returns are normally calculated based on accounting earnings and the accounting value of equity. For insurers, equity may be measured using either statutory or GAAP acounting; when using SAAP acounting , equity is termed "surplus" or "statutory surplus".

the costs of implementation. Fortunately, in measuring the historical rate of return attributable to property casualty insurance, there is little difference of opinion regarding the proper methodology for measurement. The current standard in the casualty insurance industry relies on a methodology that decomposes the total rate of return into three components: underwriting profit, investment income on insurance operations, and investment income on the insurer's equity capital (or surplus). This methodology is consistent with statutory accounting standards promulgated by the National Association of Insurance Commissioners (NAIC) (as exemplified by the financial reporting contained in the insurance annual statement), as well as insurance industry sources and publications (such as the reports published by A.M Best Co.).[3] In light of the work order for this engagement, it is our judgment that such an approach is appropriate for calculating the historical returns attributable to multiple peril crop insurance.

As noted above, the methodology adopted for this report separates insurance returns into underwriting profit, investment income on insurance operations, and investment income on the insurer's equity capital (or surplus). Generally speaking, the first two components, underwriting profit and investment income on insurance operations, are calculated as a percent of insurer premium, while the last piece, investment income on surplus, is denominated as a percent of surplus (or equity). Thus, to calculate the rate of return on equity, the portion of the return denominated as a percent of premium must be multiplied by the ratio of premium to equity, and then added to the investment return on the equity itself.

In algebraic form, the equation for the total return on equity is as follows:

$$ROE = [UW_\pi * (1-t_u) + IY_{op} * (1-t_i)] * (P/E) + IY_{eq} * (1-t_i)$$

where: UW_π = underwriting profit as a percent of premium
t_u = federal income tax rate on underwriting income
IY_{op} = investment return from insurance operations as a percent of premium
t_i = federal tax rate on investment income
P = premium
E = equity
IY_{eq} = investment return on insurer equity

[3] See, for example, the NAIC (a), *Accounting Practices and Procedures Manual* Vol. 1; NAIC, Report on Profitability by Line and by State in 2000; or Best's Aggregates & Averages, 2002 edition.

While the equation above may appear to decompose the total return in a counter intuitive manner[4], there is actually both logic as well as a strong tradition to support such an approach. The purpose of this method is to distinguish the returns attributable to being in the business of insurance from the returns attributable to investing one's own equity capital. Note that in the first term to the right of the equal sign, the value IY_{op} reflects the return attributable solely to the investment of funds provided from insurance operations. These are the funds insurers receive from policyholders (in the form of premium payments) that are held for the future payment of losses and/or expenses; insurers invest such funds and earn income associated with those investments. Since underwriting profit reflects returns solely from underwriting (i.e., the difference between premiums and associated losses and expenses), and given the definition of IY_{op}, the first term to the right of the equality represents the entire return insurers earn as a result of being in the business of insurance.

In contrast, the second term to the right of the equality represents the return the insurer earns from investing it's own equity capital. Such a return could have been realized without bearing the risk of underwriting insurance, by simply using the insurer's equity to purchase its existing asset portfolio. Thus, decomposing the total return as done in the equation above provides a useful distinction between the returns associated with engaging in the insurance activity and the returns associated with investing the insurer's own capital. So long as the insurance activity imposes some risk, the first term on the right should be positive (i.e., the insurance activity should provide a positive return), but in evaluating whether the insurer earns a "fair and reasonable return" it is appropriate to consider all sources of income (including investment income on the insurer's equity).[5]

A discussion of each individual component of the rate of return is provided below.

2.1 Underwriting Profit

Underwriting profit in property casualty insurance is normally defined as the difference between premiums earned and the sum of losses and expenses incurred, as follows:

$$UW_{\pi} = P - IL - ILAE - UE$$

where: P = Earned Premium
IL = Incurred Losses
ILAE = Incurred Loss Adjustment Expense

[4] It might appear more intuitive to separate the underwriting from the investment portions of the insurance business; such an approach would group all investment income together, so as to distinguish between the underwriting and investment activities pursued by insurers.

[5] In theory, it is possible that the returns to insurance underwriting are inversely correlated with the market. In a CAPM context, this would imply that investors would be willing to assume insurance liabilities for a total return below the risk free rate, which would further imply that the first term in the equation would be negative. While this theoretical possibility has been discussed, there is, to our knowledge, no empirical evidence supporting it.

$UE =$ Other Underwriting Expenses[6]

Although this could be computed in absolute dollars, each value in the equation is typically divided by earned premium, so the reported results are expressed as a percent of earned premium, as shown below:

$$UW_\pi/P = P/P - IL/P - ILAE/P - UE/P, \text{ or}$$
$$uw_\pi = 1 - il - ilae - ue$$

where the use of lower case indicates that the values are reported as a percent of earned premium.

This approach to measuring underwriting profit is reasonable for the typical property casualty line of business, because the actuarially developed premium collected by the insurer is intended to cover both the losses and the expenses associated with the insurance contract. In MPCI, however, these two components are separated: "premium" as the term is used in MPCI, refers to the estimated amounts needed to pay only the losses associated with the insurance contract.[7] The expenses associated with the underwriting, delivery and servicing of the contract are separately reimbursed through the A&O (administrative and operating) subsidy. Thus, the standard approach requires modification due to the nature of multi peril crop insurance.

The alternative approach we rely upon in this report simply decomposes the equation above into two pieces, one related to the pure underwriting profit (which is simply the difference between gross premium and incurred losses) and the other related to the "profit" arising from the A&O subsidy.[8] Thus, we recast the equation above as follows:

$$UW_\pi = \text{Pure } UW_\pi + A\&O_\pi,$$
$$\text{Pure } UW_\pi = P - IL^{9}$$
$$A\&O_\pi = A\&O \text{ subsidy} - ILAE - UE$$

To estimate the pure underwriting profit, we relied on data provided by RMA in the "reinsurance runs", which provide a summary of the underwriting results for each insurance provider, by fund and plan of insurance. While the reinsurance runs provide detailed results of the premiums and losses distributed by fund and for several plans of insurance, the final computations display the ultimate

[6] For many lines of business, insurers may pay dividends (in effect refunds) to policyholders at the expiration of their policies. If so, underwriting profit would be calculated after such dividend payments. However, for MPCI policyholder dividends are irrelevant, hence they are excluded from further discussion here.

[7] This "gross premium" is itself split into two parts, the producer paid premium and the premium subsidy (i.e., the amount paid by the government on behalf of the producer).

[8] To the extent that the A&O subsidy exceeds the actual operating expenses of the insurer, there is a potential profit to be earned. Of course, if the subsidy falls short of actual expenses, the insurer could incur a loss as well.

[9] Incurred loss in MPCI is typically referred to as "indemnities" paid to producers.

results of interest in a profitability analysis, namely, the net retained premium and loss for the insurance provider, aggregated across all states. As such, the difference between the two is the value required for the variable Pure UW_{π}: that is, it reflects the final underwriting profit after all provisions of the SRA are taken into account.[10]

2.2 Expenses

Property casualty insurer expenses are normally categorized into classes that include: loss adjustment expense (the costs of investigating, adjusting and settling claims)[11]; acquisition costs (commissions to agents and other acquisition expenses); general overhead expenses; and taxes, licenses and fees (where taxes refers to premium and miscellaneous taxes, excluding income tax). When rates are set for property casualty insurance, these expenses are estimated and included, along with the provision for losses, in determining the final premiums paid by insureds.

In contrast, for MPCI reinsured under the SRA, the FCIC compensates insurers for the costs of selling and servicing the coverage through the payment of an administrative and operating (A&O) subsidy. This A&O subsidy is intended to cover all costs associated with the sale and servicing of crop insurance policies, excluding, of course, losses. This raises at least two important issues as regards profitability analysis. First, depending on the level of the A&O subsidy relative to actual incurred expenses, there may be a profit or a loss to insurance providers attributable to the subsidy itself. Second, when evaluating crop insurance expense ratios relative to expenses for other lines of insurance, it is imperative to adjust the ratios to put them on a comparable basis.[12]

This latter point bears additional explanation. Consider a line of insurance such as homeowners, and assume that a policy is issued for a premium of $100, under which there is $70 of expected losses and $30 of expected expenses.[13] In this instance, the reported expense ratio for the insurer would be 30% ($30 of expenses divided by $100 of premium). Now compare that to an MPCI policy with expected losses of $70 and an A&O subsidy of 30%. On such a policy, an insurer would be entitled to $21 to cover expenses (30% of $70 in gross premium, where gross premium is set equal to the expected value of loss). If this information were recorded consistent with the reporting of all other lines of insurance, instead of a 30% expense ratio for MPCI, the value would be approximately 23% (i.e., $21 of expenses divided by $91 of premium) because the premium would include both the loss

[10] The SRA conatins a variety of provisions relating to the maximum amount of premium that can be written in the Assigned Risk fund, the minimum retentions required for the provider, and the rules for reapportioning premium if the maxima are exceeded, or increasing retentions if the minima are not met. These are all accounted for in the reinsurance run, as is the stop loss protection provided under the SRA. Thus the reinsurance run provides all the data required to evaluate the pure underwriting profit that is ultimately retained by the insurer.

[11] Loss adjustment expenses are typically reported along with losses, not with other underwriting expenses.

[12] This issue has relevance for the determination of the premium to surplus ratio as well. We will discuss this in a later section of the report.

[13] For ease of exposition in this example, we assume there is no profit built into the premium.

($70) and the expense ($21) portions of the rate. Alternatively, if we were to adjust the homeowners data to report it on the same basis as MPCI, the homeowners expense ratio would be almost 43% (i.e., $30 of expense divided by $70 of loss).

As this example demonstrates, it is inappropriate to directly compare the A&O subsidy (in this case 30%) to the reported expense ratios for other lines of insurance, because the premium base in the denominator of these ratios represents different things. In typical property casualty insurance, the premium includes both losses and expenses, while in MPCI the premium includes losses only. To put the A&O subsidy on a comparable basis to expense ratios reported for other lines of insurance, one must add the subsidy to the premium, so as to produce a denominator that is comparable to "normal" premium in other lines. This can be accomplished using the following calculation:

Adjusted expense ratio = [(A&O subsidy)/(1 + A&O subsidy)].

Thus, if the A&O subsidy were set at 25%, that would be equivalent to a reported expense ratio of 20% in any other line of insurance (i.e., 25%/(1.0 +25%) = 20%).

Turning now to the issue of the impact of the A&O subsidy on profitability, as indicated in our previous discussion, the subsidy could increase provider profits if it exceeds actual expenses, and could decrease profits if it falls short of actual expenses. Unfortunately, there is very little information available to determine which of these is the more likely scenario. Below we discuss two sources of such information; a GAO audit report from 1997, and the expenses reported by MPCI insurers on the statutory financial statements filed with insurance regulators.

2.2.1 GAO Study

The GAO study was published in 1997, and is based on an audit of 9 companies that sold approximately 80% of all Federal crop insurance in 1994 and 1995. According to the GAO, these companies reported $542.3 million of expenses (equal to about 29% of premium) and received $580.2 million of reimbursement (31% of premium) under the SRA.[14] In the report, the GAO suggested that the expense reimbursement could be reduced to 24% for several reasons discussed below.

1) Of the expense reported, $43 million were not reasonably associated with the sale and service of Federal crop insurance. These expense were related to
   - Acquiring competitor's businesses,
   - Protecting companies from underwriting losses (reinsurance costs),
   - Sharing profits through bonuses or management fees,

[14] In this discussion, unless otherwise indicated, the premium is defined using the nomenclature typical in crop insurance – that is, the premium represents the loss portion of the rate only, excluding expense.

- Lobbying, and
- Reporting errors and omissions.

2) Of the remaining expense items, the GAO considered some of the travel expenses, agent commissions and entertainment expenses (collectively around 3% of premium) to be excessive, based primarily on either subjective judgment or because they were substantially above the average of other companies.

3) The GAO further suggested that increases in premium rates and crop prices over time, as well as the higher premium levels of the (then) new revenue plans of insurance, would reduce the expense ratio in the future because there is no additional work or expense required in handling a larger premium volume simply because of a higher premium rate.

It is not our purpose in this study to debate the conclusions of the GAO report, however we have several observations regarding those conclusions.

First, and perhaps most important, the GAO concluded that an expense reimbursement equal to 24% of premium would be reasonable in light of their audit of actual company expenses. Currently, the SRA provides for an A&O subsidy ranging from approximately 21% to 24.5% of premium, depending on the fund and plan of insurance. As a consequence, assuming expenses as a percent of premium have remained constant over time, the current A&O subsidy would not be viewed as excessive, regardless of the historical levels of the subsidy.

Second, we found several of the GAO conclusions and recommendations inconsistent with the objective of delivering multi peril crop insurance through the private sector. For example, expenses related to acquiring a competitor's book of business, or paying incentive compensation to employees, are parts of the cost of doing business in the private sector. If crop insurance is to be delivered though this mechanism, then insurers will have to compete for resources to support crop insurance on the same terms as would any other business activity.

Finally, the GAO's statement that the expense reimbursement could be reduced in the future because crop prices and premiums will increase must be considered in light of several facts. First, a substantial share of insurer expenses is directly dependent on premium. Agents' commissions, which represent a significant portion of expenses (more than half according to the GAO report) are usually a fixed percentage of premium. As to other expenses, a substantial portion of these are related to employment costs, which tend to increase faster than the general level of prices.[15] Finally, premium

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[15] In 2001,approximately 65% of insurer expenses were for salaries and employee benefits (see Best's Aggregates and Averages). According to the Bureau of Labor Statistics, employment costs over the past two decades increased at an annual rate of more than 4% on average. Labor productivity growth for the service sector, on the other hand, has substantially lagged behind the growth in the manufacturing sector and productivity growth in the insurance

increases may reflect expected loss increases, which in turn might result in higher loss adjustment expenses. This is especially true for the introduction of new types of coverage such as revenue assurance. Thus, it is unclear whether increases in the average premium per policy would be sufficient to offset the cost increases associated with higher expenses labor costs.

Despite our concerns regarding these issues, the fact remains that the GAO report provides some evidence that the A&O subsidy may have been excessive in the past relative to actual insurer expenses. Thus one consideration in evaluating the historical rate of return would be the potential for insurers to have realized a profit on the A&O reimbursement.

2.2.2 Statutory Financial Statement Data

In contrast to the GAO report's suggestion that the A&O subsidy has exceeded actual expenses, there are data from insurer annual statements that indicate the opposite – that is, that the expense reimbursement has fallen short of actual expenses. These data are available for MPCI for all years from 1992 to the present, from the statutory financial reports insurers file with regulators. However, according to the NAIC, there was no standard practice in annual financial reporting for multiple peril crop insurers, and thus it is difficult to interpret the financial statement data for years prior to 2001.[16]

In 2001, the NAIC Accounting Practices and Procedure Manual was substantially revised to clarify the financial statement reporting for the multiple peril crop insurance. Based on the new Accounting Procedure Manual (NAIC (a), 2001, page 78-5), which applies to SRA contracts effective after January 1, 2001:

> The expense payment (A&O subsidy) associated with the catastrophic coverage shall be recorded as a reduction of loss expenses whereas the expense payment for the buy-up coverage shall be recorded as a reduction of other underwriting expenses. (Explanations added in parentheses.)

It thus appears that at least for calendar year 2001, the statutory annual statement should provide expenses incurred by crop insurers net of A&O subsidy only.

Since the statutory annual statement is the only source of expense data available for almost the entire sample period, and it contains data for other lines of property-casualty insurance that could be a

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sector was close to zero for the period 1987-2000. (see Brookings Institution Workshop on Service Sector Productivity in May 17, 2002).

16 See, NAIC (b) (2002, page IP108), "Existing statutory accounting practices do not address the distinctive characteristics of the MPCI line of business. Current practices within the industry vary". A review of the data strongly suggest that this is the case; for example, the MPCI expense ratios, as shown in Table 2, fluctuate signfiicantly from year to year, indicating likely inconsistent data reporting.

useful reference, we conducted a comprehensive review of these data. We obtained the financial statement data from multiple versions of Thompson's CD Rom U.S. Insurance: Property-Casualty (also called the SheShunoff CD, or formerly called OneSource).[17] The expense ratio of multiple peril crop insurers as a whole, together with the expense ratio of all other property-casualty lines of business, is reported in Table 2 below.

According to Table 2, for each year since 1993, (including 1994 and 1995, the years of the GAO audit) multiple peril crop insurance as a whole has a positive expense to premium ratio, averaging 14.9% over the entire sample period. Therefore, if the annual statements were reported consistent with the current guidelines of the NAIC Accounting Practice Manual, then it would appear that multiple peril crop insurers have had an expense ratio from 1.2% to 27.3% (average 14.9%) in excess of the A&O subsidy. In light of the GAO study, these numbers appear suspicious. On the other hand, if we compare the expense ratio of multiple peril crop insurers with other lines of insurance, the MPCI expense ratio is actually quite low. Consider the following: during the 1993-2001 period, the average A&O subsidy was roughly 29% and the average reported expense ratio for MPCI was 15%. Therefore if the reporting was correct, the MPCI total expenses were around 44% (29%+15%). Adjusting that value for the fact that the premium for other lines of insurance is expense loaded (as discussed earlier), the MPCI expense ratio is really around 30.5% (i.e., 44% expenses divided by one plus 44%), on a basis comparable to other lines. This is substantially lower than most lines of property-casualty insurance.

[17] Thompson financial is a widely relied upon source of information for the financial sectors in general. The Thompson Financial CD contains detailed annual and quarterly statutory filings on more than 3,200 P&C companies, including 6 years of exhibits and schedules, and line of business information by state.

Table 2. Expense to Premium Ratio based on Annual Statement data.

Line of Insurance	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Aggregate Write-Ins For Other Lines Of Business	29.5%	29.2%	28.3%	27.7%	24.1%	28.4%	27.0%	18.3%	28.5%	33.1%
Aircraft (All Perils)	45.7%	42.3%	41.0%	39.2%	35.8%	34.4%	37.0%	44.8%	40.8%	-11.2%
Allied Lines	47.3%	45.7%	42.8%	43.0%	42.0%	44.1%	42.5%	44.6%	46.7%	48.9%
Boiler And Machinery	54.9%	55.2%	49.3%	48.3%	47.4%	50.6%	49.4%	55.2%	47.4%	50.5%
Burglary And Theft	44.4%	44.4%	37.2%	38.5%	38.2%	40.1%	34.7%	50.5%	41.2%	38.8%
Commercial Auto Liability	43.7%	43.5%	44.2%	43.9%	45.0%	43.6%	44.0%	47.9%	45.4%	46.1%
Commercial Auto Physical Damage	37.6%	37.6%	39.2%	38.4%	39.1%	38.9%	39.1%	42.5%	38.8%	37.6%
Commercial Multi Peril (Liability)	68.5%	66.4%	61.3%	60.3%	61.9%	55.0%	62.8%	58.3%	56.7%	60.8%
Commercial Multi Peril (Non Liab)	45.8%	45.6%	48.3%	46.7%	47.8%	49.9%	47.3%	47.4%	47.1%	45.4%
Credit	63.0%	59.6%	50.5%	45.9%	45.4%	46.0%	48.0%	49.9%	48.5%	43.9%
Credit A & H	43.7%	72.8%	65.1%	52.5%	56.9%	61.1%	69.3%	80.7%	82.7%	72.2%
Earthquake	32.6%	30.9%	120.4%	45.9%	43.5%	28.7%	47.6%	49.0%	52.2%	51.1%
Farmowners Mutliple Peril	41.5%	42.6%	41.2%	41.3%	42.0%	41.7%	43.2%	44.0%	42.7%	42.8%
Federal Flood						-665.3%	26.4%	13.3%	408.4%	-813.0%
Fidelity	41.2%	43.1%	41.4%	43.7%	40.1%	40.7%	43.8%	40.9%	47.0%	40.7%
Financial Guaranty	58.3%	43.3%	50.6%	51.3%	44.2%	41.6%	37.1%	37.1%	43.3%	34.9%
Fire	45.4%	46.2%	44.2%	41.2%	40.9%	43.4%	43.2%	46.8%	45.4%	45.9%
Group A & H (See Interrogatory 1)	20.7%	21.0%	22.4%	23.7%	22.4%	24.0%	24.5%	24.4%	22.1%	20.3%
Homeowners Multiple Peril	45.0%	43.3%	44.1%	43.7%	43.6%	43.9%	44.4%	43.6%	42.6%	43.1%
Inland Marine	45.0%	45.8%	46.4%	44.9%	42.2%	43.9%	42.9%	43.1%	44.0%	42.6%
International	28.8%	32.3%	32.8%	33.0%	29.0%	24.9%	24.7%	24.2%	45.6%	49.9%
Medical Malpractice	49.5%	46.3%	44.3%	49.8%	49.3%	50.7%	54.3%	57.1%	56.2%	55.0%
Mortgage Guaranty	31.1%	28.5%	27.2%	24.0%	22.2%	23.0%	27.6%	28.3%	23.6%	24.5%
Multiple Peril Crop	**21.6%**	**27.3%**	**12.5%**	**6.3%**	**1.2%**	**10.3%**	**13.3%**	**15.5%**	**16.9%**	**24.5%**
Ocean Marine	45.3%	41.9%	42.4%	39.6%	38.4%	44.7%	43.1%	45.8%	37.8%	39.1%
Other A & H (See Interrogatory 1)	31.1%	34.3%	31.4%	28.0%	34.6%	35.7%	39.6%	34.6%	29.0%	25.5%
Other Liability	54.5%	57.5%	58.0%	62.5%	52.9%	51.9%	50.5%	55.3%	51.3%	50.4%
Pvt. Passenger Auto Liability	36.6%	35.9%	34.4%	34.8%	34.9%	36.2%	38.3%	39.3%	38.9%	38.7%
Pvt. Passenger Auto Phys. Damage	31.4%	31.1%	31.2%	31.8%	31.8%	33.3%	34.6%	33.3%	40.6%	34.9%
Products Liability	76.7%	79.5%	59.8%	84.6%	91.1%	72.6%	70.9%	73.9%	69.9%	108.3%
Reinsurance Nonprop. Assumed	35.6%	33.0%	30.8%	34.9%	35.4%	33.4%	33.6%	29.7%	31.9%	32.2%
Surety	67.5%	65.3%	64.9%	59.0%	59.6%	62.4%	64.5%	63.2%	61.5%	63.9%
Workers' Compensation	30.9%	31.3%	33.2%	34.6%	39.3%	40.0%	42.6%	45.2%	43.9%	46.2%
Total	**39.6%**	**39.2%**	**39.2%**	**39.7%**	**39.7%**	**39.9%**	**41.1%**	**41.3%**	**41.7%**	**41.1%**

Source: Thompson Financial CD: U.S. Insurance Property-Casualty; various editions. Note that multiple peril crop data is available from annual statement starting from 1992 only and so we only prepared the data starting in 1992

2.2.3 Summary

In light of the uncertainties about expenses suggested by the GAO report and the annual financial statement data, we have chosen to report historical profitability calculations under three hypothetical scenarios, as follows:

1. The A&O subsidy exactly compensates insurers for their expenses; in this case, the A&O subsidy produces zero profit. We refer to this as the base case throughout the report.
2. The GAO report is correct and insurers have been overcompensated through the A&O subsidy; for illustrative purposes, we assume there is a 3% annual profit due to the A&O.
3. The statutory annual statement data is accurate, and insurers have been under compensated through the A&O subsidy; for illustrative purposes, we assume there is a 3% annual loss due to the A&O.

All the rate of results provided in the body of this report are displayed for the base case only, assuming there is neither a profit nor a loss in the A&O subidy. In the detailed calculations in the appendix, we provide results under the two alternative scenarios.

2.3 Investment Gains On Insurance Operations

In a typical line of property casualty insurance, the insurer collects premium in advance of the payment of losses and expenses. In fact, in some lines of business, there may be a lag of many years between premium receipt and the final payment of loss.[18] In such lines, investment income plays a major role in insurer pricing and profitability, as the funds advanced by policyholders are invested by the insurer, and can earn significant income. However, the amount of such income depends primarily on the amount of time between the receipt of funds from policyholders and the disbursement of those funds by the insurer.

To evaluate the investment income opportunities for MPCI insurers, we considered the timing of the cash flows attributable to the sale of crop insurance. The dates that are relevant for such an analysis are the dates at which the insurer; (1) receives premium from the policyholder; (2) remits the premium to RMA; (3) pays losses; (4) receives reimbursement for the loss payment; (5) receives the A&O subsidy; and (6) pays expenses. Based on the timing of these cash flows, it is evident that investment income from insurance operations is a relatively immaterial consideration in the profitability of MPCI insurers.

To illustrate this analysis, consider as a reference point the following important dates for corn producers, provided by extension economist, William Edwards of Iowa State University.

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[18] In a line like workers compensation, payments may extend sixty or seventy years after the sale of a policy, as benefits under the coverage can last for the lifetime of an injured worker.

Table 3. Important Dates for Corn Producers

Sales Closing Date	Mar. 15, 2002
Final Planting Date	Mar. 31, 2002
End of Late Planting Period	Jun. 25, 2002
Acreage Reporting Date	Jun. 30, 2002
Billing Date	Oct. 1, 2002
End of Insurance Period	Oct. 10, 2002
File Notice of Crop Damage Date	15 days after end of insurance or Dec. 10, 2002
Policy Termination Date	Mar. 15, 2003
Production Reporting Date	Apr. 29, 2003

Source: http://www.extension.iastate.edu/Publications/FM1858.pdf

The sales closing date is the last date for producers to apply for or cancel crop insurance coverage. Final planting date is the last planting date to receive full coverage, with coverage being reduced daily during the late planting period. Production reporting date is the last day to report the production records for the calculation of APH history.

The following are the transaction dates for the major cash flow components for the insurer.

Premium: At the billing date, (corn in Iowa has a 10/01/2002 billing date), the insurer (reinsured by the FCIC) bills the insured for the producer's portion of the premium due. The insured has until the end of the month to pay their premium to the reinsured company. If the insured has not paid by the end of the month, the insurer charges the insured interest until the premium is collected.

The month following the billing date, (November in this example), the premium is due RMA whether the reinsured company has collected it from the producer or not. If it was collected, it is reported as a paid amount on the next accounting report.[19] If the company does not pay RMA the uncollected premium then interest will attach at the rate of 15% per year. They, however, cannot defer the uncollected premium beyond the annual settlement. The annual settlement date is February 28, 2003

Indemnity: Once the insured notifies the insurer of a loss, the insurer documents the claim and then issues the insured a check drawn on their loss clearing account and submits the loss data to RMA. RMA processes loss data and funds the escrow account for 100% of the loss check amount issued. When the insured's check hits the company's loss account, the funds are then transferred from the escrow account to the loss clearing account to cover the check. If the reinsured company has a net underwriting loss prior to annual settlement, the amount must be paid to RMA, however if there is a net underwriting gain, it is calculated in February, following the end of the reinsurance year.

[19] If the insured has not payed the premium by the policy termination date, they are terminated for indebtedness and made ineligible for program benefits.

A&O Subsidy: When the premium data is submitted to RMA the A&O Subsidy is calculated using the gross premium, which includes the producer's subsidized portion, times the applicable reimbursement percentage. For the 2002 reinsurance year 24.5% is the maximum percentage rate and 21.1% is the minimum. The insurer receives the A&O subsidy at around the middle of the insurance period.

It is clear from these dates that the potential to earn investment income is relatively modest for multiple peril crop insurers, because the time period during which they could invest premium revenue is virtually nil. In fact, premium is remitted to the FCIC almost immediately after its receipt by the insurer. In addition, the A&O subsidy is provided to the insurer in the middle of the insurance period, despite the fact that a large portion of expense is incurred at the time the policy is sold. Thus, the insurer has to finance a portion of expenses in advance of reimbursement. While the A&O subsidy provides revenue in excess of these "prepaid expenses", and that excess could be invested, it is unlikely that investment income from that portion of the A&O exceeds the cost to the insurer of financing expense outlays ahead of reimbursements. Finally, there is an asymmetric timing of underwriting gains versus losses; losses must be remitted prior to the settlement date, while gains are received at the settlement date.[20]

Given these facts, there is apparently no meaningful opportunity for insurers to earn investment income from insurance operations. (Indeed, it could be argued that there is an investment cost rather than a gain, due to the early payment of expenses and the timing of underwriting gains versus losses.) As a consequence we have assumed, for the purposes of our profitability analysis, that MPCI insurers receive no investment income form insurance operations.[21]

2.4 Investment Income on Equity

As discussed earlier, in addition to investment income from operations, insurers also earn income from the investment of their own equity. In the case of MPCI, this is, in fact, the only source of meaningful investment income for the insurer. To estimate the historical investment income on insurer equity, we relied upon the average yield insurers actually earned on their invested asset portfolios during the period between 1989 and 2001.[22]

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[20] The recovery of underwriting gains for an individual year is constrained to some extent by the reserve requirements, which are discussed more completely later in the report.

[21] It is important to note that the annual statement for property casualty insurers will generally show positive amounts of investment income attributable to MPCI operations. However these positive values result from the fact that there is a mandatory formula used to allocate investment income to line of business. Based on our review of the typical timing of MPCI cash flows, we see no basis for attributing any investment income to insurance operations.

[22] We used the average yield for the entrire property casualty industry rather than the yield earned by MPCI insurers to be consistent with the insustrywide cost of capital. That is, since we compare the historical returns from crop insurance to an industrywide reasonable rate of return (cost of capital), it is appropriate to impute the industywide

To estimate this value, we compiled data from insurer annual statements reported by *Best's Aggregates and Averages*, the standard reference source in the field. For each year in the sample period, we calculated the ratio of net investment income earned plus realized capital gains divided by average invested assets, and assumed that that was the yield rate that applied to the insurers surplus during the year.

Table 4. Property-Casualty Average Rate of Return on Investment

Year	Year-End Cash and Invested Asset	Average Invested Asset	Net Investment Income	Return on Investment
1987	360,752,329			
1988	401,776,313	381,264,321	30,448,735	8.0%
1989	445,077,013	423,426,663	35,855,938	8.5%
1990	470,493,393	457,785,203	35,781,530	7.8%
1991	514,564,282	492,528,838	39,053,096	7.9%
1992	539,656,015	527,110,149	43,627,153	8.3%
1993	579,833,900	559,744,958	42,462,989	7.6%
1994	609,505,252	594,669,576	35,350,775	5.9%
1995	664,008,342	636,756,797	42,830,658	6.7%
1996	700,806,046	682,407,194	47,206,297	6.9%
1997	766,061,919	733,433,983	52,306,925	7.1%
1998	796,780,574	781,421,247	57,944,582	7.4%
1999	799,060,669	797,920,622	51,871,077	6.5%
2000	789,330,250	794,195,460	56,908,285	7.2%
2001	781,730,299	785,530,275	44,369,989	5.6%

Note: Average invested asset equals current and last year-end average.
Return on investment equals net income divided by average asset.

As would be expected, average returns were substantially higher in the earlier years, as interest rates were generally higher at the time, and insurers also benefited from the higher yields of older bonds in their portfolios.

To use these values in the profitability calculation, we made the standard assumption that the entire allocated equity is invested for the whole year of the transaction, hence investment income on equity is equal to the annual yields shown above.

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investment portfolio to crop insurance. If crop insurers have riskier (or less risky) asset portfolios, their costs of capital would be commensurately higher (lower).

2.5 Taxes

Since the actual return earned by investors is the after tax return, the rate of return comparable to the reasonable rate of return expected by investors is the after tax return as well. Thus, after the various income items have been calculated, they must be adjusted for tax. To do so, we relied on the appropriate statutory tax rates in effect during each year of the sample period.

Both underwriting and investment gains are subject to Federal income taxes. Based on data from World Tax Database, the marginal corporate income tax rate on the top tax bracket has been 34% from 1989 through 1992 and 35% from 1993 through the present. For the lower income brackets, the corporate income tax rate for the period 1989 through 2002 ranges from 15% for the first $50,000 to the range between 34% and 39% for income above $100,000.[23] We used the tax rate for the top bracket as the corporate income tax rate for our estimation of the tax rate on underwriting income.

The tax rate on investment gains is somewhat more complicated because a significant portion of stock dividends and tax-exempt bond interest are tax-exempt. Consistent with our approach of using the average investment return of all property-casualty insurers, we also used the industrywide average tax rate on investment income as proxy for the investment return tax rate for crop insurers. Since investment income varies by asset categories, we estimated this tax rate by the weighted average tax rate across all investment asset categories.

Due to the enactment of the 1986 Tax Reform Act, 15% of all tax exempt investment income is treated as taxable for property casualty insurance companies. This includes both the interest on tax exempt bonds as well as 70% of stock dividends from unaffiliated companies. (Note that effective tax rate on stock dividends is estimated by taking 15% of the 70% of dividends that are exempt, plus the 30% of dividends that are non-exempt, and multiplying that by the corporate tax rate. The effective tax rate for each of the investment asset categories are presented in the table below.

23 The tax rates were designed such that companies reaching the top income brackets will pay an average tax rate that equals the tax rate of the top income bracket.

Table 5. Tax Rates on Asset Categories

	1989-1992	1993-2001
Bonds		
Taxable	34.00%	35.00%
Non-Taxable (.15*corp. tax rate)	5.10%	5.25%
Stocks		
Taxable ((.15*.7+.3)*corp.tax rate)	13.77%	14.18%
Non-Taxable (.15*corp. tax rate)	5.10%	5.25%
Mortgage Loans	34.00%	35.00%
Real Estate	34.00%	35.00%
Collateral Loans	34.00%	35.00%
Cash	34.00%	35.00%
Short Term Inv.	34.00%	35.00%
All Other	34.00%	35.00%
Inv. Expenses	34.00%	35.00%
Realized Capital Gains	34.00%	35.00%

Note: Non-taxable stock yields are yields from affiliated companies.

Given the effective tax rates shown in Table 5 above, we also estimated the weighted average effective tax rate for each year in the sample period. Table 6 below presents the distribution of investment income across each of the asset categories, along with investment expense and realized capital gains from investment. These data are from various editions of *Bests Aggregates & Averages: Property-Casualty Edition*. Using these data as the weights for each category, the average tax rate is computed and shown in the bottom panel of Table 6. We used these tax rates as proxies for the investment income tax rates for crop insurers.

Table 6. Property-Casualty Investment Portfolio Income Distribution and Average Tax Rate

	2001	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991	1990	1989	1988
	Investment Income, Expense, and Capital Gains													
Bonds														
Taxable	22,302,424	22,029,009	21,108,088	21,776,005	22,192,677	21,284,291	20,165,755	18,120,773	18,083,944	18,885,479	18,763,192	16,481,406	14,035,065	11,953,865
Non-Taxable	9,654,683	10,543,361	11,420,119	11,544,948	10,833,496	10,726,038	10,626,881	10,981,827	10,455,805	10,741,904	10,489,143	10,656,171	10,726,809	10,317,076
Stocks														
Taxable	2,621,526	2,849,541	2,874,275	2,911,625	2,875,690	2,646,601	2,553,112	2,516,031	2,285,418	2,279,760	2,240,548	2,506,084	2,485,226	2,191,046
Non-Taxable	1,405,226	1,326,160	1,156,400	1,690,919	3,614,550	1,329,733	1,544,022	1,089,813	746,344	676,854	764,493	763,103	951,739	912,925
Mortgage Loans	137,721	261,656	173,858	203,942	230,349	238,435	268,985	354,500	447,315	559,142	622,667	664,301	595,889	578,549
Real Estate	1,649,181	1,570,896	1,544,685	1,600,494	1,585,364	1,469,337	1,415,893	1,403,581	1,327,026	1,189,602	1,062,592	919,027	862,449	765,359
Collateral Loans	0	0	0	0	7,538	7,861	7,375	8,350	8,277	11,727	19,002	22,222	26,795	22,610
Cash	596,201	224,289	163,035	187,099	145,552	146,875	155,193	113,323	107,887	147,369	226,325	309,561	320,557	233,664
Short Term Inv.	1,203,685	2,145,556	1,855,876	2,104,432	2,041,421	1,915,691	2,113,673	1,246,789	1,101,885	1,144,607	1,881,931	2,233,902	2,699,557	1,958,448
All Other	2,418,157	3,568,273	2,339,694	1,615,424	1,531,706	1,277,202	1,024,305	823,475	855,653	802,575	713,144	765,914	680,191	619,539
Inv. Expenses	(4,253,706)	(3,815,818)	(3,782,299)	(3,709,511)	(3,559,449)	(3,079,984)	(3,040,951)	(2,971,192)	(2,774,150)	(2,705,768)	(2,536,299)	(2,420,647)	(2,176,400)	(1,830,516)
Capital Gains	6,630,679	16,204,649	13,016,157	18,019,189	10,807,929	9,243,907	5,997,029	1,663,541	9,817,573	9,893,402	4,806,376	2,880,410	4,648,681	2,725,466
Total	44,365,777	56,907,572	51,869,888	57,944,566	52,306,823	47,205,987	42,831,272	35,350,811	42,462,977	43,626,653	39,053,114	35,781,454	35,856,558	30,448,031
	Average Tax Rate													
Ave. Tax Rate	26.4%	27.8%	26.6%	27.2%	25.6%	26.2%	25.3%	23.4%	26.0%	25.4%	24.5%	23.4%	23.2%	26.4%

2.6 Determination of Equity Capital[24]

Determining the capital required to support insurance exposures is an issue that has received a great deal of attention in the literature. Generally speaking, determining the appropriate amount of capital by line requires (1) the choice of a capital base, as well as (2) a method ofallocating the aggregate amount of capital to individual lines of insurance. Possible choices for a capital base for property/casualty insurance include surplus calculated according to statutory accounting principles (SAP) or generally accepted accounting principles (GAAP), or the market value of equity[25]. As to allocation methods, they would include a variety of rules for apportioning surplus according to various measures of risk by line. (Several allocation bases have been suggested in the insurance literature, which we will mention below.)

As regards the capital base, the proper measure from an economic perspective would be the market value of equity, as this is the base upon which investors require a return. It is also the true economic value of the enterprise.[26] However, market values can fluctuate (sometimes dramatically) over time, and to our knowledge are never relied upon in practical regulatory applications. This leaves either statutory surplus or GAAP equity as the capital base upon which the return should be calculated. As regards the choice between these two options, it is widely agreed that when comparing insurance returns to other industries, the proper capital base is GAAP net worth. And since the allowed return in ratemaking is designed to permit insurers a return equal to that earned in industries of comparable risk, the equity base upon which that return is measured must be comparable as well. This suggests that GAAP net worth is the proper base for regulatory purposes.[27]

While GAAP net worth has historically been between 10% and 25% greater than SAP surplus, the recent codification of statutory accounting principles will tend to mitigate the differences between the two. However, differences will inevitably remain. Therefore, we would recommend that RMA utilize a conversion factor to transform statutory surplus, as reported on the insurance annual statement, to a GAAP equity equivalent. If such an analysis had been done based on the most recent 5 years of industrywide data, the conversion factor would have been 1.13 (i.e., GAAP net worth was 13%

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[24] A similar section is also presented in Appel et al (2002). However in our discussion here, we emphasize several important issues that impact the use of this factor in a historical profitability analysis.

[25] Surplus measured using GAAP is conventionally called net worth, a nomenclature adopted above.

[26] Neither SAP surplus nor GAAP net worth will equal the economic value of an insurer's equity, i.e., the market value of its assets less the market value of its liabilities. Differences between accounting and economic surplus reflect a variety of considerations, including the reporting of loss reserves at nominal rather than discounted value, the reporting of certain bonds at book rather than market value, and other factors, including the substantial off-balance sheet assets of many insurers that reflect their investments in distribution systems, employee training, claims facilities, name brand recognition and reputation.

[27] The NAIC uses GAAP equity when reporting results by state and line in its annual Profitability Report. That document is quite clear in its preference for GAAP over SAP accounting.

greater than statutory surplus), while in the most recent year the conversion factor was 1.14.[28] Using the most recent value as an example, this implies that for every $100 of statutory surplus allocated to crop insurance, the insurer actually has $114 of GAAP equity allocated to the line.

Before leaving the issue of capital base, it is important to emphasize one additional consideration, as follows. Assuming that aggregate industry capital is to be allocated across lines of the insurance, the total amount of capital to be allocated must be the actual, current capital held by the insurance industry[29]. This is critical because the degree of risk to which insurers are exposed, and hence the required return, is dependent on the amount of insurer capital (or operating leverage); if the capital base were, for example, smaller, insurers would be perceived as riskier and hence their cost of capital would be higher.[30] Since the cost of capital is developed based on current capital market conditions, consistency demands that the amount of capital assumed to support insurance transactions be the actual amount as well.

Turning now to allocation of the capital base, we note at the outset that an insurer's surplus is inherently indivisible, in that the entire amount is available to protect all of its policyholders. Moreover, while models have been developed to allocate surplus, there is no widespread agreement on the appropriate method or allocation base. Indeed, there is no widely accepted and computationally tractable way of measuring risk by line, hence the allocation of capital is inherently problematic. Nevertheless, RMA must determine a reasonable amount of capital to be attributed to crop insurance, in order to structure the SRA to yield a fair and reasonable return. Thus, we briefly discuss those allocation bases which have traditionally been proposed in insurance regulatory settings.

As indicated earlier, in theory capital should be allocated to line of insurance based on each line's relative risk. Ideally, if capital could be allocated in such a way as to equalize risk by line, then a single rate of return for all lines would be appropriate.[31] However, despite literally decades of research, there is still no consensus regarding the proper measurement of risk by line. (Furthermore, most recent research has been directed to the question of capital allocation within a firm, and is not necessarily

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[28] For an example of such a calculation, see Testimony of David Appel *In The Matter of The Filing Dated Feb. 1, 2002 By the North Carolina Rate Bureau*, North Carolina Department of Insurance Docket No. 1073. Since codification is to take effect for 2001 annual statements, any estimates should be revised based on the new statutory accounting rules.

[29] Some analysts have argued that the capital base on which a return is allowed should be determined based on normative rules; for example one common rule of thumb is that capital should be set equal to 50% of the insurer's written premium in a particular line. Such a rule fails to ensure consistency between the cost of capital (i.e., the insurance industry's perceived risk) and the other assumptions built into the ratemaking process.

[30] See Brealey and Myers (1996, page 456-457) for a discussion of the impact of financial and operating leverage on the cost of capital.

[31] We recognize that all risk differences will not likely be eliminated through the allocation of capital. For example, differential amounts of capital will tend to equalize default risk by line, but there may be other risks (such as earnings volatility) which are partially but not fully addressed by such allocations. The decision to rely on the average cost of capital and to address risk differences through capital allocation is the pragmatic approach that has been widely adopted in insurance regulatory proceedings.

applicable to industrywide allocations to state and line.) Despite the lack of consensus, practitioners have typically relied on one of several allocation bases: premiums; loss reserves; total (loss and loss adjustment expense plus unearned premium) reserves; or total reserves plus earned premium.[32]

As to the methods that have been used in practical applications, allocations based on total reserves or reserves plus earned premium, appear to have the most promise. In fact, both of these methods have some support in the regulatory arena, with the latter one favored by the National Association of Insurance Commissioners (NAIC) and implicitly utilized in the financial reports required to be filed by insurers with regulators in every state.[33] The idea behind these approaches is that insurers face risk from unforeseen events relating to current business as well as from past business for which claims have yet to be paid. Thus, capital should be available (and hence allocated) to protect against adverse current period loss experience as well as adverse loss development from prioryears. This leads to an allocation based on either total reserves (which includes loss, loss adjustment expense and unearned premium reserves), or total reserves plus earned premiums.

Since the NAIC relies on an allocation based on total reserves plus earned premiums, we would recommend relying on the same method. Although there may be arguments in favor of other allocation bases, the fact that the total reserves plus earned premiums method is supported by the NAIC lends strong support to the use, by RMA, of this method as well. We have calculated leverage ratios for all lines of property casualty insurance using this allocation base, based on data as of yearend 2001. (In this context, leverage ratios are defined as the ratio of net written premiums to statutory surplus.) These are shown in Table 4 below. We note two things about these results: (1) the calculations allocate all of the industry's surplus, and are not adjusted to any particular normative level, and (2) they are based on industrywide reserves and premium, rather than the reserves and premium of a sample of insurers.

The results of the allocation process show a premium to surplus ratio for multi peril crop insurance of 2.2 to 1, which is notably the highest premium to surplus ratio for any line of insurance. We have two observations about this value. First, the computations are displayed rounded to a single decimal place; in our view, no higher degree of precision is warranted in light of the uncertainty associated with any surplus allocation method. Second, and more importantly, the results of the surplus allocation process seem anomalously low, and hence the premium to surplus ratio is unusually high, in light of the catastrophe risk potential present in the sale of crop insurance.

There are two principal reasons this latter result occurs; one is that multi peril crop insurance has amongst the smallest unearned premium reserves relative to premium of any line of insurance, and the other is that MPCI reported premium is understated due to the absence of an expense provision.

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32 More recent capital allocation methods, such as those based on ruin probability, value at risk, policyholder deficit and options theory, have not been sufficiently well developed to emerge in the regulatory arena. See, for example, recent papers by Myers and Read (2001) and Butsic (1999), which use options models to allocate insurer capital.

33 One section of the Statutory Annual Statement, the Insurance Expense Exhibit, allocates surplus to line of business using the algorithm relied upon in this report.

Since both earned premiums as well as the unearned premium reserve are part of the allocation base, and both these values are understated for crop insurance, there is a commensurately smaller allocation of surplus to the line.

As far as the unearned premium reserve is concerned, the low value is likely the result of the fact that premiums in crop insurance are often not paid until the exposure has virtually expired, hence by the time the premium is booked, it is already earned. Since the unearned premium reserve (UEPR) is the difference between written and earned premium, the UEPR for crop insurance will be very small. As evidence of this, consider that the UEPR for all lines of property casualty insurance averages approximately 41% of premium, while for crop insurance it is less than 8% of premium. Had the all lines average UEPR to premium ratio applied to crop insurance, the same allocation methodology would have produced a premium to surplus ratio of 1.7.[34]

In addition to the artificially low UEPR, the other bias in the allocation method results from the fact that MPCI premiums include a provision for losses only, as opposed to the typical property casualty insurance premium that includes both losses and expenses. As we discussed earlier, in order to put MPCI premium on a comparable basis to other lines, the A&O subsidy must be added to the reported premium.[35] Given the size of the subsidy, this has a meaningful impact on the allocation of surplus. In fact, if the premium were put on a consistent basis with other lines of business, the amount of surplus allocated to MPCI would increase by more than 15%, and the premium to surplus ratio would decline from approximately 1.7 to around 1.4.

Because it appears that the very low value for the MPCI unearned premium reserve likely reflects accounting anomalies rather than a true measure of the risk in the exposure, and because the premium is understated due to the absence of expenses, we think that prudent judgment would argue in favor of a lower value than that indicated by the raw data. Therefore, we would recommend using a premium to surplus of 1.4, based on a judgmental selection in light of all available information.[36]

In addition, as noted earlier, the leverage ratios computed above are based on an allocation of statutory surplus, while the appropriate capital base upon which a return should be allowed is GAAP net worth. To adjust these ratios to a GAAP net worth basis, one would divide by the ratio of GAAP

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34 To derive this value, we replaced the observed UEPR with an estimated value based on the all industry average ratio of unearned premium reserve to written premium.

35 In effect, other lines of business have surplus allocated for both losses and expenses, whereas MPCI has surplus allocated for losses alone. It is therefore appoprriate to make the adjustment indicated above when allocating surplus, and determining the amount of surplus supporting the crop insurance transaction. However, when calculating the premium to surplus ratio for use in the rate of return calculation, the premium in the numerator of that ratio should be the MPCI reported premium (and not the adjusted premium) since the MPCI premium is the base for the other relevant components of the rate of return calculation.

36 From a risk exposure perspective, the line of business most closely related to MPCI is Allied Lines, the line under which MPCI is actually reported on the annual statement. This line has a premium to allocated surplus ratios of approximately 1.4,which provides aditional support for our judgmental selection.

equity to statutory surplus, which was 1.14 for the property casualty insurance industry in the most recent year. Assuming that value applied to crop insurance, and the premium to allocated surplus ratio was set at 1.40, the ratio of premium to GAAP net worth would be estimated to be 1.20 (i.e., 1.4/1.14=1.2).

Table 7. Allocation Of Surplus To Lines Of Business Net of Reinsurance Data From 2001 Insurance Expense Exhibit (000 omitted)

		Premiums Written	Premiums Earned	Unpaid Losses	Defense and Cost Containment Expenses Unpaid	Adjusting and Other Expenses Unpaid	Unearned Premium Reserves	Allocated Surplus	Implied P/S Ratio
1	Fire	4,885,823	4,536,573	2,985,673	169,036	100,744	2,722,005	3,724,232	1.3
2.1	Allied Lines	3,727,835	3,250,266	2,141,542	86,048	97,271	1,722,006	2,584,757	1.4
2.2	Multiple Peril Crop	1,236,971	1,143,435	367,626	354	2,223	94,471	569,617	2.2
2.3	Federal Flood	3,465	2,762	913	135	1,256	-375	1,662	2.1
3	Farmowners Multiple Peril	1,633,714	1,599,578	512,831	81,741	44,631	798,314	1,075,786	1.5
4	Homeowners Multiple Peril	35,132,592	33,726,539	9,728,502	1,416,497	1,156,190	19,146,958	23,085,881	1.5
5.1	Commercial Multi Peril (Non-Liability Portion)	12,972,359	12,135,468	5,777,395	927,031	426,253	6,738,547	9,211,265	1.4
5.2	Commercial Multi Peril (Liability Portion)	9,255,719	8,813,336	15,147,344	5,234,255	828,335	4,262,222	12,144,451	0.8
6	Mortgage Guaranty	3,136,711	3,116,304	4,767,472	37,778	97,462	474,387	3,008,495	1.0
8	Ocean Marine	1,945,735	1,836,857	1,680,717	127,255	55,428	709,429	1,561,979	1.3
9	Inland Marine	6,571,582	6,239,322	2,035,250	120,206	128,158	3,575,314	4,285,387	1.5
10	Financial Guaranty	1,823,249	1,238,868	394,394	9,245	3,588	6,489,008	2,881,579	0.6
11	Medical Malpractice	6,072,468	5,631,919	15,824,517	4,317,301	783,508	2,909,580	10,437,605	0.6
12	Earthquake	846,835	797,815	262,283	34,607	28,728	459,293	560,626	1.5
13	Group A & H (See Interrogatory 1)	8,360,906	8,558,706	3,141,680	42,509	79,791	394,650	4,327,569	1.9
14	Credit A & H	473,844	492,376	79,462	146	3,823	153,237	258,239	1.8
15	Other A & H (See Interrogatory 1)	5,544,701	5,184,061	1,989,463	50,765	99,303	2,135,109	3,350,418	1.7
16	Workers' Compensation	25,962,502	24,779,260	56,040,912	4,845,712	3,251,836	6,307,608	33,730,283	0.8
17	Other Liability	19,872,240	18,744,005	47,624,594	10,453,371	2,705,712	12,007,302	32,423,107	0.6
18	Products Liability	2,018,399	1,764,330	8,078,724	2,749,586	461,100	862,556	4,929,367	0.4
19.1, 19.2	Private Passenger Auto Liability	74,376,471	73,069,734	59,698,042	8,365,863	5,102,255	23,202,473	60,017,689	1.2
19.3, 19.4	Commercial Auto Liability	15,270,121	14,374,410	17,779,621	2,176,463	962,200	7,187,548	15,047,159	1.0
21.1	Private Passenger Auto Physical Damage	53,460,420	52,546,998	2,723,233	229,437	910,095	17,282,104	26,102,799	2.1
21.2	Commercial Auto Physical Damage	6,474,612	6,211,131	797,858	85,231	87,532	2,841,092	3,550,246	1.8
22	Aircraft (all perils)	947,030	864,105	1,439,187	116,821	32,680	441,223	1,025,105	0.9
23	Fidelity	860,082	845,071	693,652	85,841	44,507	539,388	782,270	1.1
24	Surety	3,058,721	3,113,504	1,941,325	335,089	109,361	2,073,403	2,682,361	1.1
26	Burglary and Theft	120,841	115,996	42,510	5,115	1,739	67,832	82,600	1.5
27	Boiler and Machinery	1,078,635	949,373	516,246	26,883	21,707	563,333	735,897	1.5
28	Credit	623,108	628,743	201,938	6,914	3,082	319,353	410,901	1.5
29	International	219,844	193,760	716,438	9,849	5,127	77,292	355,089	0.6
30, 31, 32	Reinsurance Non-proportional assumed	12,748,243	12,800,606	44,510,403	2,586,512	659,173	3,195,432	22,581,989	0.6
33	Aggregate write-ins for other lines of business	2,732,881	2,167,228	-336,992	14,402	-8,136	4,033,209	2,079,142	1.3
34	TOTAL (lines 1 through 33)	323,448,636	311,472,568	309,304,708	44,748,077	18,286,678	133,785,354	289,605,554	1.1
	Surplus	289,605,554							

Source: Best's Aggregates & Averages - Property/Casualty, 2002

2.7 Reserve Adjustment

There is one other feature of the SRA that must be accounted for when estimating the historical rate of return earned by crop insurers. According to the SRA, if the insurer's overall gain from underwriting exceeds 17.5% of its retained net book premium for the reinsurance year, 60% of the amount above 17.5% will be held by FCIC in a reinsurance account for the insurer. If the insurer retains an overall loss or an overall gain less than 17.5% of its retained net book premium in any reinsurance year, any balances in the insurer's reinsurance account will be paid to the insurer to the extent needed to retain an overall gain of 17.5% of retained net book premium, or a lesser amount if the balance in the account is not adequate to achieve this percentage.[37] Two years after the first annual settlement for a reinsurance year, the remaining balance of funds from the reinsurance year will be returned to the insurer. There is no interest from the reserve account.

This reserving requirement in essence reduces the present value of the cash flow to insurers. In the computation of the actual rate of returns, we considered two approaches to adjust for this effect. One is to use the overall underwriting gain net of this reserve as the actual underwriting gain, and the alternative is to calculate the present value of the reserve portion of the underwriting gain, to reflect the delayed timing of its receipt by the insurer. The problem with the first approach is twofold: for one, we do not have the reserve data for several of the reinsurance years, but more importantly, reliance on this method would not accurately reflect the profitability of the relevant reinsurance year. Rather, it would reflect the combined profitability of current and previous reinsurance years which contributed to the balance of the reserve account. We chose to use the second approach because it provides an estimate that is, in our opinion, economically more meaningful.

The following assumptions were made to compute the reserve adjustment: First, since we do not have complete data on the cash flow of the reinsurance accounts, we chose to apply the average duration of the reserves to all insurers. Specifically, for each reinsurance year from 1989 through 2000, we computed the respective percentages of reserves from the reinsurance year that were returned to the insurer in one year and two years. For this calculation, for the first year that a company appeared in the reinsurance database, we assumed that they had zero balance in their reserve accounts. Based on this assumption, for each reinsurance years, if an insurer had a reserve, we computed the respective percentages of the reserve returning to the insurer in one year and two years, given that balance in the reserve account is on a first in first out basis. For details, consider the following scenarios:

1. The company has return exceeding the 17.5% limit in the next reinsurance year. It is determined that 100% of the reserve returns in two years.

[37] The exceptions to these rules include if Company owes debt to the FCIC or if there is litigation or arbitration between the company and FCIC. In addition, if the Company terminates the contract, 50% of the balance will be paid to the Company at the date of the annual settlement. The other 50% will be paid one year later. If FCIC terminates the SRA, the remaining balance will be paid 1 year after the annual settlement.

2. The company has a return less than 17.5% in the next reinsurance year, and the shortage is less than the reserve from the last year. It is determined that 100% of the reserve returns in two years.
3. The company has a return less than 17.5% in the next reinsurance year, and the shortage is larger than the sum of reserve from last year and the current year reserve than it is determined that 100% of the reserve is returned next year.
4. The company has a return less than 17.5% in the next reinsurance year, and the shortage net of the reserve from last year is less the current year reserve. It is determined that percentage of returned in one year is equal to (next year's net gain short of 17.5% - balance of reserve from last year)/(current year reserve). One minus the first year percentage gives the percentage of reserve returns in two years.

Then, we computed the simple average percentages of reserves returning in one year and two years across all insurers and all years 1989-2000. (Year 2001 is excluded because there is no data for next year profitability.) Based on this calculation, on average, 27% of the reserve returned to the insurer after one year and 73% returned to the insurer in two years.

For the final reserve adjustment, when there is net gain exceeding 17.5%, we assume that 27% of the reserve returns to the insurer in one year and 73% of the reserve returns in two years. Therefore, 27% of the reserve is discounted by the average investment yield rate for the current year and 73% of the reserve is discounted by the average yield for the subsequent year.[38]

2.8 Summary of Components

The following table provides a summary of the components of the rate of return computation. We also note that the underwriting data are in reinsurance years, while the expense, investment return and tax rate data are in calendar years. The reinsurance year is defined as the period from July 1 of the previous calendar year to June 30 of the current year – for example, reinsurance year 1990 is calendar period July 1, 1989 through June 30, 1990. Thus, to place the calendar year data on a reinsurance year equivalent basis, we used the average of the two calendar years contributing to the same reinsurance year.

[38] Some might argue that it is appropriate to discount by the cost of capital, since that is the estimated fair rate of return for crop insurance. However, in this case, the cash flow to be discounted is not risky; it is, in fact, a gain that has already been earned, and is effectively nearly guaranteed by the government. Therefore, we chose to discount by a rate that reflects the relative risk of the cash flow.

Table 8. Summary of Components of Rate of Return Calculations

Components	Definitions
Rate of Return	[(Underwriting profit + A&O profit) * (1-corporate income tax rate) * premium to equity ratio] + surplus investment return * (1-tax rate on investment return)
Underwriting Profit	Return on premium retained after stop loss. If it is above 17.5%, 60% of return after stop loss is discounted by reasonable rates of returns as discussed in Section 2.4.
A&O Profit	A&O subsidy – (Loss adjustment expense + commission brokerage + general expense + other expense+ taxes, licenses and fees)
Investment Return on Operations	Assumed to be zero due to timing of cash flows
Investment Return on Equity	net investment income / total of cash and invested assets (for all property-casualty insurers).

3. Results

Using the approach discussed above, we estimated the rate of return on equity for each individual insurance provider, by fund, with and without the impact of catastrophe coverage, for each reinsurance year from 1989 through 2001. The following section presents a summary of the most important results of that analysis, while the detailed results by provider are contained in the appendix attached to this report. In this section, we discuss only those results from the "base case" expense assumptions, where the A&O subsidy is assumed to produce neither a profit nor a loss for the insurer.

3.1 Aggregate Summary Rate of Returns

The table below presents a summary of the estimated actual rate of return for MPCI insurers in the aggregate, compared to the estimated reasonable rate of return, for each year in the sample.

As can be seen from the table, the estimated earned return on equity for MPCI insurers has averaged approximately 15.8%, as compared with an average reasonable rate of return over the same period of 14.0%. Thus, while MPCI insurers have earned a return somewhat in excess of the cost of capital, the returns have been somewhat volatile as well, as evidenced by the fact that in the single catastrophe year the overall rate of return was –15.6%. We would caution against drawing any strong conclusions on the adequacy or excessiveness of the historical returns based on a sample of thirteen years of data, in light of the fact that only one of those years is a catastrophe year. Had there been a second catastrophe year in the sample similar in magnitude to 1993, the average return over the period would have been below 14%.

Table 9. Average Return on Equity and Reasonable Rate of Return by Reinsurance Year: All Insurers, Funds and Plans Combined

Year	Average	Average Excluding Cat	Reasonable Rate of Return
1989	16.8%	.	14.8%
1990	21.2%	.	15.9%
1991	16.6%	.	16.2%
1992	12.5%	.	15.4%
1993	(15.6%)	.	14.5%
1994	25.8%	.	13.4%
1995	21.3%	.	13.7%
1996	22.2%	.	13.4%
1997	25.0%	.	13.2%
1998	16.6%	14.8%	12.7%
1999	13.9%	11.8%	12.9%
2000	14.2%	12.6%	12.7%
2001	15.5%	14.0%	13.1%
Average	15.8%	13.3%	14.0%
Std. Deviation	10.4%	1.4%	1.2%

The following table further provides the summary statistics for the annual total rate of return of individual insurers with and without the catastrophic insurance component. Note that in this table, the average annual returns differ from those reported earlier. In Table 9 above, the average annual return was calculated for the aggregate industry; in effect, this is a weighted average return on equity across all firms, where the weights depend on the individual firm's size. In Table 10, the averages are unweighted, or, alternatively, each observation is accorded equal weight. The purpose of this analysis is to observe the variation in returns across firms during a year, as opposed to the variation in industry returns over time.

Table 10. Summary Statistics for Individual Insurer Rates of Return by Reinsurance Year: Aggregates of All Insurers, Funds and Plans

Period	All				Excluding Cat.			
	Average	Std. Dev.	Max	Min	Average	Std. Dev.	Max	Min
1989	14.0%	7.2%	25.8%	2.3%	.	.	.	.
1990	21.1%	8.5%	35.5%	-7.1%	.	.	.	.
1991	14.8%	6.4%	20.9%	-7.9%	.	.	.	.
1992	13.3%	14.6%	31.5%	-36.9%	.	.	.	.
1993	-19.3%	20.2%	12.5%	-64.5%	.	.	.	.
1994	24.4%	8.2%	36.1%	5.5%	.	.	.	.
1995	22.2%	12.5%	41.6%	-10.1%	.	.	.	.
1996	23.5%	9.8%	36.7%	3.5%	.	.	.	.
1997	26.6%	5.0%	35.1%	17.3%	.	.	.	.
1998	19.7%	10.7%	33.8%	-11.6%	18.6%	11.8%	34.8%	-12.0%
1999	17.2%	7.7%	30.1%	6.0%	16.2%	8.8%	31.6%	5.4%
2000	14.7%	9.3%	30.5%	-8.2%	13.5%	9.9%	31.1%	-9.8%
2001	15.7%	12.9%	36.3%	-16.1%	14.6%	13.6%	36.6%	-16.5%
89-01	16.0%	10.2%	31.3%	-9.8%	15.7%	11.0%	33.5%	-8.2%
98-01	16.8%	10.2%	32.7%	-7.5%	15.7%	11.0%	33.5%	-8.2%

Notice that there is significant cross sectional variation within each year: the average coefficient of variation (i.e., the ratio of the standard deviation to the mean rate of return) is about 60%, with the variation slightly bigger when catastrophic insurance component is excluded. Also, it is interesting to note that the average annual return is lower when the catastrophic risk protection plan of insurance is excluded. This indicates that at least for this sample period, cat coverage has been profitable for insurers.[39]

3.2 Rate of Returns by Provider

We also estimated rates of return for individual insurance providers, which are displayed in summary form in Table 11 below (along with the weighted average of all providers and the reasonable rate of return). As discussed earlier in the report, these estimates are based on the actual underwriting results for the individual providers, along with assumptions regarding insurer leverage and investment returns that are based on property casualty insurance industry averages. We note again that these annual returns will differ from those that may be reported by the individual insurance providers.

[39] We note that none of the years for which the cat coverage data are available were catastrophe years, therefore it is not necessarily surprising that total returns were higher including cat coverage.

The last column to the right in Table 11 is the standard deviation of the provider's return from 1989 through 2001 (the inter-temporal standard deviation), based on the number of observations available. Notice that the average of the inter-temporal standard deviations across all providers (13.8%) is larger than the average of the cross sectional standard deviations reported in the bottom row (10.2%). This suggests that there is substantial correlation in profitability among insurers.

3.3 Rate of Returns by Fund

In addition to estimating total returns for the industry as a whole and for individual providers, we also estimated the return by provider by fund. The following table presents the summary rate of return results for the industry in the aggregate, by fund with and without catastrophic insurance.[40] (More detailed rate of return by provider by fund results are reported in the appendixes.) For each fund, the average and standard deviation of the rate of return is reported.

The results are generally in line with expectations, in that the commercial fund is the most profitable, while assigned risk is the least profitable. In addition, assigned risk has the lowest standard deviation, probably because of the stop loss provisions in the SRA.

[40] Notice that adjustment to compute the present value of reserve was not performed for the computation of individual fund profitability, and thus the results are slightly different not quite comparable with the results aggregating all funds.

Table 12. Summary Statistics by Fund, With and Without Catastrophic Insurance*

Reinsurance Period	Assigned Risk Avg.	AR Std Dev	AR Excl Cat	AR Ex Cat. Std Dev	Develop-mental Ave	Dev. Std Dev	Dev. Excl Cat	Dev Ex Cat Std Dev	Com-mercial Ave	Comm. Std Dev	Comm. Ex Cat	Comm. Excl Cat Std Dev
1992	4.7%	2.7%	.	.	7.0%	7.9%	.	.	14.2%	16.1%	.	.
1993	3.7%	3.9%	.	.	-2.5%	10.4%	.	.	-20.7%	21.1%	.	.
1994	6.9%	1.9%	.	.	14.4%	4.2%	.	.	31.0%	13.0%	.	.
1995	4.6%	2.7%	.	.	9.0%	7.1%	.	.	25.4%	14.8%	.	.
1996	5.7%	2.3%	.	.	9.9%	7.8%	.	.	26.6%	8.0%	.	.
1997	7.6%	1.5%	.	.	13.2%	5.0%	.	.	34.3%	8.2%	.	.
1998	4.7%	2.2%	4.5%	2.0%	6.6%	7.8%	6.0%	8.2%	18.8%	11.3%	17.1%	12.6%
1999	3.9%	2.4%	3.9%	2.1%	5.8%	9.4%	5.5%	9.4%	16.2%	8.5%	14.0%	9.7%
2000	4.2%	2.2%	4.1%	2.1%	7.1%	7.6%	6.5%	7.7%	16.5%	11.1%	14.8%	11.9%
2001	3.5%	2.1%	3.5%	1.8%	5.3%	7.8%	5.0%	7.9%	19.0%	14.8%	17.4%	15.8%
1992-2001	4.9%	.	4.0%	.	7.6%	.	5.7%	.	18.1%	.	15.8%	.
1998-2001	4.1%	.	4.0%	.	6.2%	.	5.7%	.	17.6%	.	15.8%	.

* Averages represent industry aggregate results (i.e., weighted averages); Standard deviations are unweighted.

4. Comparison with reasonable rate of returns.

In a separate report prepared for the RMA, Milliman estimated the reasonable rate of return for multiple peril crop insurance for the years 1989-2001. The reasonable rate of return is defined as the consensus expected rate of return by investors in general in the given point of time. The estimated reasonable rates of return for multiple peril crop insurance are shown in Table 12.

To compare the actual rate of return with the reasonable rate of return estimates, Table 12 displays both series. We caution that actual returns could deviate significantly from the expected returns because of unexpected events. Therefore a better measurement of whether providers have been reasonably compensated is by comparing mean values over the sample period, and by observing the pattern of difference between actual and reasonable rate of return. The difference between the actual rate of return and the reasonable rate of return is also displayed in the following table.

Table 13. Actual Vs. Reasonable Rate of Returns Aggregated Over All Funds and Providers

Year	Reasonable Rate of Return	Actual Rate of Return	Difference between Actual and Reasonable
1989	14.8%	16.8%	2.0%
1990	15.9%	21.2%	5.3%
1991	16.2%	16.6%	0.4%
1992	15.4%	12.5%	-2.9%
1993	14.5%	-15.6%	-30.1%
1994	13.4%	25.8%	12.4%
1995	13.7%	21.3%	7.6%
1996	13.4%	22.2%	8.8%
1997	13.2%	25.0%	11.8%
1998	12.7%	16.6%	3.9%
1999	12.9%	13.9%	1.0%
2000	12.7%	14.2%	1.5%
2001	13.1%	15.5%	2.4%
Mean	14.0%	15.8%	1.8%

As can be seen in the table, the actual rate of return is 1.8% larger than the reasonable rate of return for all years, however, the standard deviation of the difference is 10.2%. Given the magnitude of the standard deviation, the difference does not appear to be statistically significant. In addition, as noted earlier, this result is quite sensitive to the occurrence of catastrophe years in the sample period. For example, if there had been a second catastrophe year equivalent to 1993 in this sample period, the historical return would have been below 13.7%.[41]

As with most lines of insurance that have a significant catastrophe exposure, insurers expect to earn significant profits in non-catastrophe years and significant losses in years with catastrophes. As a result, average returns over relatively short sample periods are not necessarily indicative of the long term pattern or returns. Given the experience in multi peril crop insurance over the past 13 years, we would suggest that the historical returns reported herein would tend to overstate long term returns if the frequency of catastrophes is greater than one in thirteen years, and understate rsuch returns if the frequency is lower than one in thirteen.

5. Conclusion, Limitations and Acknowledgement

The Risk Management Agency (RMA) of the U.S. Department of Agriculture (USDA) requested Milliman USA (Milliman) to recommend and implement a methodology, based on insurance industry standards, to calculate the historical rate of return attributable to the sale of multiple peril crop insurance reinsured through the Standard Reinsurance Agreement (SRA). This engagement required Milliman to estimate the actual rate of return for multiple peril crop insurance (MPCI) for the reinsurance years 1989 through 2001 at the aggregate level, as well the returns for individual providers, funds, and years, with and without the impact of catastrophe coverage.

To respond to RMA's request, Milliman developed and implemented a model to estimate historical rates of returns and then applied that model to data for multiple peril crop insurers, for the period between 1989 and 2001. The results of our analysis are contained in this report.

Limtations

Inherent Variability

It is important to realize that all actuarial projections of future contingent events are subject to a high degree of uncertainty. This is particularly true for highly volatile coverages such as multiple-peril crop insurance. Our analysis reflects our best professional judgment, however, substantial variance of actual results from our projections is not unexpected.

Data Sources

In performing this analysis we relied on data provided to us by RMA. We have not audited, verified, or reviewed these data and other information for reasonableness and consistency. Such a review is

[41] We replaced the lowest return year, 1992, with –15.6% (the return earned during the catastrophe year, 1993) and the all years mean fell to 13.7%. Replacing any other year would have caused the mean to fall even further.

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Committee on Agriculture
U.S. House of Representatives
Information Required From Non-governmental Witnesses

House rules require non-governmental witnesses to provide their resume or biographical sketch prior to testifying. If you do not have a resume or biographical sketch available, please complete this form.

1. **Name:** Greg Burger

2. **BusinessAddress:** Farmers Crop Insurance Alliance
PO Box 1088
Eau Claire, WI 54702

3. **Business Phone Number:** 1-715-834-8155

4. **Organization you represent:** American Association of Crop Insurers

5. **Please list any occupational, employment, or work-related experience you have which add to your qualification to provide testimony before the Committee:**

President of Farmers Crop Insurance Alliance/North Central Crop Insurance for the past 16 years.

6. **Please list any special training, education, or professional experience you have which add to your qualifications to provide testimony before the Committee:**

Board of Director of AACI, NCIS, FCIA and FAMIC; over time, have been member of several trade association committees.

7. **If you are appearing on behalf of an organization, please list the capacity in which you are representing that organization, including any offices or elected positions you hold:**

Vice-Chairman of AACI.

PLEASE ATTACH THIS FORM OR YOUR BIOGRAPHY TO EACH COPY OF TESTIMONY.

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2003.

Name: Greg Burger

Address: P.O. Box 1088, Eau Claire, WI 54702

Telephone: 715-834-8155

Organization you represent (if any): Farmers Crop Insurance Alliance

1. **Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2002, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:**

Source:__________ **Amount:**__________

Source:__________ **Amount:**__________

2. **If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2002, as well as the source and the amount of each grant or contract:**

Source:__________ **Amount:**__________

Source:__________ **Amount:**__________

Please check here if this form is NOT applicable to you: X

Signature: [signature]

* Rule XI, clause 2(g)(4) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnessess who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

PLEASE ATTACH DISCLOSURE FORM TO EACH COPY OF TESTIMONY.